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J. J. FRAWLEY

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The Province of Alberta

IN THE MATTER OF THE PUBLIC INQUIRIES ACT

—and—

IN THE MATTER OF a Commission, dated the 12th day of October, A.D. 1938, to inquire into matters connected with Petroleum and Petroleum Products

Commissioners:

The Honourable MR. JUSTICE McGILLIVRAY
(*Chairman*)

—and—

L. R. LIPSETT, ESQ.

Session:

CALGARY, Alberta JANUARY 19th, 1939

VOLUME 18

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VOLUME 18 - January 19th, 1939. Page.

WITNESSES:

E X H I B I T S

. . . .

DR. BYRON B. BOATRIGHT,

having been recalled, examined by Mr. Frawley said:

Q Dr. Boatright, I think we had better begin this morning by reverting to the question Mr. Nolan asked you yesterday and the Chairman said he would like to have you deal with, it had to do with the drilling out of the reserves.

A Last night I went into the calculation which Mr. Nolan requested and before giving this figure I wish to state that the figure I am giving is pretty much of a "horse back" figure under the definition which we already have for figures of that type.

A true analysis and a figure which would mean much of anything would have to be derived as a result of at least a weeks' work. It involves a large number of questions and for that reason any figure given now would be purely an estimate on my part. The figure which I believe to be reasonable but which as I say has no backing up by a critical study of the data is from 10 to 15 wells a year for probably the next five years with a gradual decrease from that time on.

Q THE CHAIRMAN: Now that is relating to what question?

A A question I believe of Mr. Nolan's concerning how many wells that would be necessary to drill each year in the Turner Valley field in order to maintain production at its present rate of 6,000,000 barrels per year.

Q I just wanted the question in the same book with the answer?

A I see.

MR. FRAWLEY: As a matter of fact it appears at page 2384 where Mr. Nolan asked it.

THE CHAIRMAN: Yes, but it would be convenient to have them together.

Q MR. FRAWLEY: Now, Dr. Boatright, I want to call your attention to some questions and answers on page 676 of the record on the 17th of December, the questions began with Major Lipsett asking you, at page 675:

"Q. MAJOR LIPSETT: You did say something, Dr. Boatright but you did not pursue it, about the amortization which has already taken place in the pipe which has been built, at the rates which have been charged? A. Yes. As a matter of fact, the figures shown by our accountant indicate that, the figures prepared by our accountant indicate that the pipeline has already been amortized by the profits of the pipeline operation. Q. MAJOR LIPSETT: Is that the pipeline you referred to that was completed twelve or thirteen years ago? A. Yes, that is this pipeline we are discussing here, of the Royalites. I think there are three lines, as a matter of fact, there are two four inch lines and one six inch line, and I believe that an analysis of the accounts of that company will show that the profits made from the pipeline charges to date have already amortized that investment. Q. That is the first pipe, or all of the pipes? A. All of it. The present value of the whole plant. Of course, I am giving the figures which were prepared by accountants. Q. Yes. A. And which probably the Royalite accountants will not agree with, but I happen to have had access to those figures and those figures indicate that in the past history of the Royalite Company in the Turner Valley field that their pipeline has already been amortized and that includes the complete plant. Q. Including the three pipelines? A. Yes.

It seems to me possibly that the accountants can speak of that with a great deal more authority than I can. Q. THE CHAIRMAN: It has been depreciated to the full extent? A. That is the case. Q. That is the question of what is a fair return to the carrier for carrying?"

Now----

THE CHAIRMAN: Clearly an error.

MR. FRAWLEY: I will read that question and answer again, Dr. Boatright.

"Q. That is the question of what is a fair return to the carrier for carrying? A. That is correct."

MR. FRAWLEY: I quite agree that does not appear to be the proper question?

A Yes.

Q And the Chairman can probably tell you what he meant himself but it would appear what he meant to say to you was there remained a question of what is a fair return to the carrier for carrying and you say "That is correct".

A Yes.

Q Now I just want you, you told us yesterday and took all afternoon to do it, with all the questionning you had, that in your opinion the fact that this line has been amortized by the Royalite Oil Company was not a pertinent matter to this Commission and that they are entitled to something in the rate to amortize it again?

A Yes, that is correct.

Q Did you ever have any other opinion?

A No, I did not. My interpretation of the question which you read was this, that it simply meant that the pipeline rate as a whole must be gone over, that was the idea I had

in mind in answering that question.

Q Oh yes.

A And didn't have any particular reference to the matters discussed yesterday.

Q In other words you did not intend to tell this Commission at that time at page 676 that there only remained the question of finding a fair return and the question of amortization need not be dealt with now?

A No, that was not my intention.

Q In other words, the view you expressed yesterday is the opinion you have always had?

A That I have always had, yes.

Q Now have you given some thought, there is still now, let me put it this way, in the estimation, in the arriving at the cost of operating the pipeline, there would appear to be three main subdivisions and that is, the company must have its costs both direct and indirect?

A Yes.

Q It must have in your opinion an amount to enable it to amortize its investment?

A That is correct.

Q And then there is a third one, it must have an allowance as a fair return on its investment?

A That is right.

Q And when one has arrived at all of those things then the cost equalises the rate, is that correct?

A That is correct.

Q The cost then automatically becomes the rate?

A That is right.

Q So we have discussed now all of the items, I mean only in part, you have gone over, you have discussed the question of amortization and you say you agree with what Mr. Morrison has done in the matter of the cost?

A That is correct.

Q And now have you some views as to what the fair return should be to the company on its investment?

A Yes I do. The pipelines in the United States or a large number of pipelines in the United States were studied for the year 1933 and showed a rate of return at that time of about 14.1% on the capital investment. At thattime this investigation was made for rate making purposes and it was felt that some rate less than that, a rate which must be comparable with other industries, should be adopted and a figure of 10% was set up at that time as a reasonable figure. That figure of 10% is my idea of a reasonable rate of return on an investment such as we are considering here. That figure of 10% compares favourably with the average of a large number of industries for the years 1936 and 1937, which range from 10.1 I believe to about 10.7%. That was the rate of return after depreciation and taxes and so on but before dividends. It seems to me the figure of 10% is a fair figure and that would be the figure which I would recommend.

Q Now, Dr. Boatright, there is only one other thing---

THE CHAIRMAN: What does that 10% cover?

MAJOR LIPSETT: What is it on?

Q THE CHAIRMAN: Yes.

A That 10% is a rate of return on the capital investment which takes care of the ordinary rate of return that anyone expects when they invest money plus an additional rate of interest which is necessary to take care of the inherent risk of the business involved; in other words Bonds of Canada carry interest rates of from 3.07 to about 3.34 or 4.4%. Those bonds are secured by the Canadian Government and that rate then, that 3%, approximately between 3 and 3½% represents

the interest which it is necessary to pay in order to get capital to invest at all and that is a secured investment, very slight risk involved. In the industries which have a risk involved it is necessary to add an additional increment of interest in order to take care of that element of risk and that rate is defined so that in the average of a great number of investments that additional rate of interest will take care of the unexpected hazards or unexpected loss which may occur. In other words, the interest which is charged for safety amounting to 3½% simply provides the capital. The additional interest on the overall investment will take care of the losses due to the risks of that particular business. In this case then if we adopt the figure of 10% as being the reasonable rate of interest for pipeline purposes that would mean that approximately 3½% of that interest is the interest which any capital expects on its investment, the additional 6½% is the rate which is added to take care of the inherent risk involved in that business.

Q Now, Dr. Boatright, I think that is an analysis of your 10% but the Commissioners asked you what that rate of return would be on, now it is on what?

A It is on the depreciated capital investment.

Q In other words it is on the investment after the accumulated depreciation has been deducted?

A That is correct.

Q Because that depreciation has already been gotten by the company in its annual charges?

A That is right and has been returned to the stockholders in some form or other. Now there is this about it, the company would be, logically would be allowed an interest on half of the total amount of money to be spent during each year. In other words if a company invested say $400,000.00 during the

[illegible] of the [illegible]

[illegible]

[illegible] safety [illegible]

[illegible] The [illegible]

[illegible] will [illegible]

[illegible] particles [illegible]

[illegible]

[illegible] interest [illegible]

[illegible]

[illegible] form [illegible]

year 1939 for additional capital investment then it would be my opinion that they would be entitled to interest on $200,000.00 of that capital investment, in other words, that they would be entitled to assume that that $400,000.00 would be spent exactly at the middle of the year, although in fact it is spread over the whole year, over the year as a whole, and that is very commonly done in problems such as we have here. In other words production, we are up against the same thing in production, production occurs thoroughout the whole year but for the purposes of calculation we assume the production came in after the middle of the year, although as a matter of fact it may come in a little later or a little earlier according to how the field is developed.

Q MAJOR LIPSETT: Is this a correct expression of your opinion, Dr. Boatright, supposing there is no pipeline today and if some company comes in today and spends a million dollars in building a pipeline, its own money obtained from its own sources, on an estimated life as you put it of 19 years, would the fair return on that be the rate of depreciation spread over the 19 years plus 10% per annum on the million dollars?

A On the million dollars and plus the 10% on any capital investment made during any year?

Q Yes, I am only just asking about the present?

A Yes.

Q Well then is it your view that if that company has been in existence for two years earlier and got its whole money back in that two years, putting this as a suppositious case that we should then give 10% on that million dollars although it has not been put up by the company but has been previously taken out of the rate which it was getting?

A Yes, I feel the 10% rate should apply regardless of that,

for this reason, I think I have already discussed the fact that the company was not subject to regulation at the time these excess profits were assumed to have occurred and the depreciation which the company actually charged on its own books was purely a matter of bookkeeping. Incidentally I would like to clear up something I said yesterday, I said "poor bookkeeping" and it was poor from the standpoint that we were discussing it but it may not be poor bookkeeping from some other standpoint.

Q MR. NOLAN: "Faulty" is the word.

A Faulty, there was no intention on my part to cast any aspersions on the method of keeping books.

MR. NOLAN: No, we understood that.

Q MR. FRAWLEY: No, that can be taken for granted.

A But regardless of how they received that money, if those profits were paid out as dividends to the stockholders and the stockholders then reinvested in bonds of the company and the money was used for capital expenditures that would be exactly the same condition and I would imagine the stockholders would be entitled to 10% for any capital investment, regardles of its source.

Q I am not sure it would be the same once it was paid out to the stockholders, then they would have the option whether they would put it back or not but from a practical point of view supposing that during the past two years, instead of the million dollars being got back, supposing they had only got back nine-hundred thousand?

A Yes.

Q There would be a net sum of $100,000.00 they had,actually coming out of their pockets todate?

A Yes.

in the word.

literalism on my part to cast any

of keeping books.

No, we understand that.

No, that can be taken for

Q If you gave them 10% on the whole investment that would represent 100% on the actual amount that the company was out of pocket, would it not?

A Yes, looking at it from that angle it would but I am taking it from an engineers standpoint and that is, that during the life of these operations the physical equipment underwent a certain depreciation. That depreciation occurred regardless of what that company did and in setting the rate it is necessary to arrive at the present value of that plant for rate making purposes, that between the time that equipment was put in and the present time regardless of what the company did, whether they made profits or losses or whether they spent the money for something else or paid it out in dividends, nevertheless that physical equipment underwent a certain rate of depreciation during all of that time and it seems right and reasonable to me to say that we are assuming now that the field will last 19 years and that the equipment has already served 10 or 12 or 13 years, therefore the life of that physical equipment on that basis is assumed to be about 32 years. You are now 13 years in that depreciation and therefore you have suffered a depreciation of those 13 years and the proportion that 13 bears to 32 is the total amount of depreciation that you have suffered in arriving at the present value of that plant; in other words it seems to me that this problem of depreciation is entirely separate and distinct from the question of profits or losses. It would be, my opinion would be exactly the same if the company had lost instead of gained. I think certainly the plant has a present value of so much and it doesn't matter whether the company lost three times the value of that plant in the past, they still would have a plant whose value is a certain amount,

and in making the rate it seems to be reasonable to take that value as of now and carry that on into the future and I might say that that view is supported in any number of Commission cases in the United States.

(2425 here follows)

Q THE CHAIRMAN: You have not worked out to see what rate that would bring you to on your theory have you?

A Mr. Morrison has worked these figures out and is prepared to give you them and explain them.

Q MR. FRAWLEY: Dr. Boatright, I do not want to be unfair with you. You gave me a kind of a blanket approval of Mr. Morrison's costs.

A That is to say you know he has used what he calls a labour ratio method of distributing the direct and indirect costs and there are other methods.

Q Is it your view that you fully agree with him or have you any views about that? He will stand on his own feet, but I do not want to be unfair to you. You made a blanket approval of everything he has done. If there is anything he has done that in your opinion there is some argument about, or any latitude about, I want you to tell us.

A No, I fully approve of the method Mr. Morrison used. In fact he discussed it with me before he used it. Mr. Morrison, by his method, has made a comparison of the man-hours of outside labour involved in the over-all company operations in the field at that time. The principal difference between that method and at least another labour ratio method is, whereby man-hours of outside labour involved in other than capital expenditure is used, which seems to be a faulty method for this reason. Drilling is ordinarily the sore spot in that, inasmuch as it is a capital investment, and the method whereby the capital labour was taken out would

mean that no charge would be made for supervision or other similar charges against that capital investment. In other words, they would not stand their proportionate share of the Administration costs. It seems to me that the Drilling Department in an active drilling campaign have just as much supervision as any other department, and, therefore, it should be included in the labour ratio calculation. It was for that reason that I thoroughly approved of the labour ratio basis which Mr. Morrison has assumed in working out his figures.

MR. FRAWLEY: Thank you, Dr. Boatright.

Q THE CHAIRMAN: Do you think it is necessary for the value to be ascertained? Mr. Nolan informed us he proposes to have experts speak as to the present value by an actual present evaluation. Do you say there is an advantage in adopting the method that you have, rather than taking the actual cost?

A That is another way leading to the same thing. It is merely a matter of which method is best. In my judgment the method which I have suggested is the most logical.

Q That is just what I want to know, why?

A For this reason, the valuation method, whereby the physical evaluation of the property is made as of a certain date is subject to the engineer that makes the evaluation. If we assume that the engineer was competent then that valuation probably is nearly representative of the actual value of that property at the present time. However, we take that value and then project it into the future on some reasonable

basis. That means then, in other words, that we do not take what actually occurred in the past and then take what might occur in the future, and arrive at our rate on that basis. That does not seem as fair to me or that the probability of error will be as small in using that method as it will be if we say that the whole life of the field will be 32 years, and depreciate over that whole period. In one case we are taking an actual condition that exists now, and assuming that figure is right, we project over 19 years ahead, and not making that first 13 years stand anything. That is the error inherent in that manner. In this way we are making the past 13 years stand some of the risks and it seems to me that is a clearer way of doing it than the present evaluation method whereby the physical valuation of the property is made.

Q MR. COMMISSIONER LIPSETT: I suppose the actual value would depend very largely today on whether you take your estimation that the property would go on earning money for 32 years or Dr. Link's estimate that it would cease to have earning power at the end of three years?

A Yes. An estimation of the definite life is essential to my method.

Q Or to any method?

A Yes, to any method. The life must be known even for arriving at depreciation largely. In the other method it takes no account of what had gone on in the past. It sets your present value, that is on the actual equipment on the ground. Then as to the future, it

depends on whatever the life is assumed to be.

Q I have got your view quite fully as far as I am concerned, but I am still a little anxious to hear any further matters that can be put to us, because on this basis we are giving the Royalite Oil Company the benefit of their, presumably of their estimates that the life of the field was going to be very short, and therefore, made a rate in order to get the money back out. I mean accepting your estimate we are going to give them the benefit of the depreciation spread over 31 years. They are going to get the benefit both ways on that basis.

A No, that is not what I meant to convey. The method which I am suggesting takes the life which we now think is correct and projects it back right to the start, and says to the Royalite Company""On this basis you have suffered so much depreciation up to now." In other words, we set this, what we think is a proper depreciation figure over all of their operations, regardless of their method of bookkeeping that has actually occurred as far as we know.

Q It is a little more than bookkeeping if, in fact over the past two years they got something like five or six or seven hundred thousand dollars out of production on the basis that the life was going to be very short, and they had to get their money back very quickly?

A I do not think that we can say on the basis that the life was going to be very short. They made excess profits, there is no question about that.

Q Yes. Then would it be fair to put it this way. They

Dr. Boatright.

made these excess profits in the honest belief that their full life of the field might be very short, and that, therefore, if they were going into a speculation of this sort, they had to have a rate which would protect them, and give them their money back?

A Of course, I do not have right to presume what they thought, except insofar as general pipe line practice is concerned. In general, the pipe line attempts to obtain as high a rate of return as they can, and that is what the Royalite did. In other words, any business tries to make as great profits as are possible.

Q That is a perfectly legitimate speculative business. But follow on that, is not the net result of your view, if it is sound?

A Surely.

Q That they are getting a double benefit. One is they are getting their whole money back or a great portion of it in the last couple of years, because of their belief it was so speculative they must do that, and we turn around and say on top of that we must depreciate the whole capital over again in the next 19 years. The producer must pay the capital all over again. In effect, that is what happens, is it not?

A I look at it from the standpoint of engineering and that equipment suffered a certain amount of depreciation and that comes out of their profit. The rest of it was excess profits, or profits, whether they were excessive or not. In other words, the Company made money there during that time. But during the time

they were making that money they were suffering a
certain amount of depreciation and as an engineer
I am not interested in the amount of profit.

Q It is correct theoretically - it may be sound perhaps practically, but I am not suggesting that - does it look to you startling that now we should give them the capital twice over, that we should work in that way?

A No, it does not, because any business enterprise tries to make profits.

Q Yes, and they are entitled to that?

A And take advsntage of economic situations to do that. They set a price for the transportation of oil. The producer was not required to transport his oil over that line.

Q You mentioned that yesterday. That is sound theoretically, but in practice is he not forced into accepting it or paying double the rate to bring it by truck or things like that? Was there any practical alternative that he had?

A Well he had the practical alternative in that he could shut his wells down. Of course, that would have meant deferring his investment and things like that. Economically he might have been forced into that situation, because of the peculiar economic situation existing in the Province at that time. But a Company is entitled to get, any profit-making institution is entitled to take advantage of the economic situation if they can do it, as long as they are not subject to regulations. The minute they become subject to regulations, and we make that rate, the company is forced

to accept that rate and that rate is set with the definite object in mind of being fair to everyone. Then I absolutely agree with your idea. In other words, if the Commission set that rate, based upon such facts as we know them now, them in that event I would say they would not be entitled to any further depreciation. But they were not set that way. They were not subject to anything but their own whims and the laws of supply and demand. Now we come along at this time and say "In the future it is necessary that you adopt a rate that is reasonable and we intend to set that rate." It seems to me in that event what has gone on in the past, beyond a reasonable depreciation, has no bearing on the rate to be set.

Q I suppose everybody would be in agreement that it would not be practical for every well or every two or three wells as they come in to run a pipe line?

A That is correct.

Q Someone must do it, and the Royalite people as the largest producer, and possibly with the most foresight, put in the line?

A Surely.

Q A perfectly legitimate investment and one on which they are entitled to get a profit?

A Certainly.

Q But I still would like to hear this other end discussed. They have got all their money back, if that is correct, or most of it, and having got that from their producer wells - some of which they have themselves - why should we not take that into account from a practical point of view in fixing this rate for the future? Let me put

it in this way. The public put up the money for a well, but possibly owing to the high rate on the pipe line they have not been able to get their money or a reasonable portion of it back. If they, in fact, were the people that put up the money for this extended pipe line, are they not entitled to some consideration to enable them to make some profits out of that well in the future, they having contributed in fact, if we so find, to the building of this new pipe line?

A I think they are undoubtedly entitled to protection in the future, but in the past they drilled those wells with the full knowledge of the conditions which existed at the time they drilled those wells, and, therefore, took their chances.

Q Do you think that if the facts be so, that we should give the Imperial Oil Company their capital back twice over? On the hypothesis I have put to you?

A Yes.

Q Owing to their good luck?

A Yes sir.

Q It may be sound theoretically on an accounting basis?

A I do not feel it is getting their capital back twice over in the exact sense of capital. But regardless of whether they get the total investment back twice, in profits or not, I think should be disregarded.

Q I should not perhaps have used the word capital. But they get the actual money back twice over on your view?

A Yes. I think that should be disregarded.

Q I was asking you, Dr. Boatright, also yesterday afternoon, about this extra charge of 6 cents to

this Plotkins' refinery?

A Yes sir.

Q And I did not qiite finish it. I think your view was that the gathering lines, there was no extra charge down in Turner Valley?

A That is right.

Q Now when a new well comes in down there, I am talking about any sort of a substantial well?

A Surely.

Q Is it the practice to connect the pipe line up with that well by means of a new gathering line?

A Quitte commonly, yes.

Q And is that done by the Royalite Company do you know?

A Yes sir.

Q Without any extra charge?

A That is correct.

Q The general practice you said at the other end, the delivery end, was that they delivered the oil to the various refineries?

A That is correct, free of charge.

Q In the case of the Imperial Oil, when they come to Calgary, they deliver to the Imperial Oil free of charge?

A Yes.

Q In fact on their basis they provide storage at the Imperial Refinery in addition?

A Yes.

Q Whether that is justifiable or not?

A Yes.

Q But when they come to this Plotkins' case - I want to get your idea, when you come to this Plotkins'

case, it is not now in fact delivered to his refinery out of the pipe line rate?

A That is right.

Q Does that mean that Plotkins, for his 15 cents rate or whatever the rate may be, that he is getting from the pipe line company, as a pipe line less service than is now being given to the Imperial Oil for whatever the reason may be?

A No. He is getting more service but he is paying more for it .

Q The Imperial is getting service from Turner Valley into their refinery?

A Yes sir.

Q For 15 cents?

A That is right.

Q And Plotkins instead of getting that is getting the oil delivered to another place where he does not want it, that is to say getting it delivered to the Imperial instead of to himself?

A That is right.

Q And in order to get it back he has to pay 6 cents more?

A Yes.

Q Whether that is right or not?

A Yes.

Q And this is what I wanted to get from you, would the reasonable practice be - if, assuming that the volume was substantial enough to make it pay - would the reasonable practice be for the Pipe Line Company to build different delivery pipes to each refinery including this case of Plotkins?

A Yes. In other words, the Pipe Line, if Plotkins

would furnish the storage and the line that is necessary, in that event it seems to me that the Royalite should furnish the oil direct to his refinery and eliminate that 6 cents charge.

Q In the case of the Imperial, do you know if the Royalite ran the pipe line right into the Imperial Refinery?

A Yes, they have.

Q And in order to give Plotkins the same service, qua pipe line, would they not have to run a pipe line direct to Plotkins?

A Yes, under that same basis.

Q On the 15 cent~~¢~~ rate?

A But Plotkins would be required to furnish storage.

Q Before we come to that. Assuming the storage conditions were equal, the normal service would be to run the pipe line right to Plotkins' Refinery?

A Yes, that is right.

Q But when you come to storage, you say in Plotkins' case he should provide the storage?

A Yes, because he is the refinery and that is the common practice.

Q Now your view is here that, as you have already expressed it, the Imperial should provide the storage at the Imperial refinery?

A Yes sir.

Q And it is for that reason you eliminate the charge of $36,000.00 a Year?

A That is correct.

Q Well then, assuming that Plotkins provided storage or has storage - we do not know much about his case yet - but would the reasonable thing be for the Royalite to

provide a pipe line right to his storage or the Plotkins' refinery?

A Yes sir, providing the demand was sufficient to return the expense of that additional line.

Q Down in the Valley they put it to the different wells, one of which produces a good deal less than the other?

A That is right.

Q They give a gathering line to each well?

A Yes.

Q And in the same way you think, providing there is a reasonable volume, that similar service should be given to the various refineries at this end?

A I feel that it should, yes sir.

Q THE CHAIRMAN: What would you consider a reasonable volume? After all the Imperial has said it is quite willing to provide that if it is commercially justifiable?

A In that event it certainly should be done.

Q I mean the Royalite. Have you any idea as to whether or not Mr. Plotkins, on his present demand, taken in the fashion it is now taken, is justified in proposing that he should get that service?

A Yes, I think he is justified.

Q On his present volume and his present rate of demand?

A Yes, I believe so. Although I must qualify my statement to this extent, I am not too familiar with what volume he uses. But I understand it amounts to two or three thousand barrels at intervals of time. It is my feeling that if Mr. Plotkins is running a commercial venture that the volume that he uses would justify that service. It seems to me he is

entitled to it.

Q It all comes down to dollars and cents, I take it? As to whether the Imperial should not be required to do it?

A Yes. In other words......

Q Or the Royalite as the case may be?

Q MR. FRAWLEY: Dr. Boatright, I do not know that I understand that. If I have a refinery along the line of this pipeline - no matter what my volume is - and the Royalite is transporting oil for me, my oil, and it is quite enough quantity for them to take it at the field end and to move it, and I say to them when it reaches a point opposite my refinery, "Divert it to my refinery". I have got my tanks and so on, or I would not be operating a refinery, presumably. As I felt last month, we might get clearer about that, that the expense of building that pipe line was offered to be borne by the refinery in question. But whether it is Plotkins or not, I am just talking about a refinery along the line of the pipe line. Assuming then that Plotkins is willing to pay, and I do not know whether he is or not, but assuming he is willing to pay for that 1000 yards or whatever it is of pipe line , to pay for the construction of it and pay for whatever expense in gauging is involved in that. Is there any reason to you, as an engineer, why that service should not be given to this company.

THE CHAIRMAN: What was that last statement?

Q MR. FRAWLEY: Pay for whatever extra expense there is in gauging, in measuring out and measuring in,

Dr. Boatright.

whatever expense that is?

A There is absolutely no reason why it should not be done in my estimation. I may have made a slip back a ways, and that is this, I do not think that the pipe line should be forced to put in lines. In other words, if they have a line that is in, and that line facility - their rate is based on that line facility, it should not be forced to run pipe lines to every refinery that jumps up all over the country. In other words, they put in a definite line, and that line ends at a certain place. It does not seem to me that the pipe line should be required, for instance if the British American built a new refinery, it does not look to me like they ought to be forced to put in a new line if they do not want to put it in. But if the British American want to build a line from there over into their own refinery, why then that, of course, is their capital investment.

Q Should they be entitled to cut into the Royalite trunk line at a point which the British American would select, and which they would both agree on would be the most suitable to take oil from the service line to their own refinery?

A I feel that they should.

Q And they provide the Pipe Line Branch in that case?

A Yes.

THE CHAIRMAN: What is involved in the attaching of the lines?

MR. FRAWLEY: Yes, what is involved in putting that service line in?

A Well, just cutting the main line and making a connection there and laying a line to the refinery itself and putting in a valve, the necessary valves and fittings.

Q MAJOR LIPSETT: I suppose that again would involve, Dr. Boatright, the possibility of having different pipeline rates possibly to different points, I mean to say supposing there was a refinery half way between Turner Valley and Calgary, a refinery was set up there and wanted the line tapped there and they paid that capital expenditure in connection with it, the refinery half way up, the rate there would probably, would presumably be somewhat different, if it was only half the distance, than it would be if you brought it all the way into Calgary?

A Theoretically, there would be some difference, but it would be so slight. The line charges are from where they tap the line in, half the way in; in other words, the difference in actual cost would be so little that it would be negligible so far as the practical standpoint is concerned. Theoretically, of course, there is an additional expense but that oil must be put through under general line conditions, and I do not think that there ought to be any allowance made for the fact that they tap in a line half way, as compared with the end of the line.

Q Would the additional capital outlay on the piping of it, say from half way, the other distance to Calgary, that would not affect it so far as the refinery half way down is concerned, would it?

A No, that is true, but they would not be able to deliver to that refinery unless they had the rest in that line, you see that little refinery is taking advantage of the fact that there is a pipeline in there and, therefore, all of that pipeline is necessary in order to furnish that little refinery with oil.

Q Perhaps we are getting too technical.

Q MR. FRAWLEY: What I am concerned about, Dr. Boatright whether there exists or does not exist on this pipeline company, assuming that it is now, from now on under the jurisdiction of some regulating body, whether there does or does not exist an obligation to serve the public, to serve the refineries which it finds, either along its way, well, along its way, naturally?

A Yes.

Q In your opinion, there does exist such an obligation?

A In my opinion, it does.

Q And if there were four or five refineries along that right-of-way that were willing to go to whatever expense is necessary to supply themselves with a service line, then this company should make the trunk line available to such refineries?

A Yes, as a common carrier I think that is one of their obligations.

MAJOR LIPSETT: Mr. Frawley, perhaps you will pursue that, because you are asking that on the basis that these outside refineries will put up the capital for this connection?

MR. FRAWLEY: For the service line only.

MAJOR LIPSETT: For the service line.

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MR. FRAWLEY: Yes, I appreciate your point.

Q MAJOR LIPSETT: What I wanted to put was this, that in a case where they did not give that sort of service, that connecting service, I am not talking about an unreasonable thing like putting a line into Edmonton, but where they give that service to everybody in the Valley, at that end, and to the Imperial in Calgary, would it be proper to take that into consideration in fixing a different rate for different points?

A I am, may I have him read that question back?

Q Well, I will put it to you again, they go to the Imperial, this is what I am thinking of, they go to the Imperial and they give the Imperial a complete service of putting the oil right into the refinery for 15¢?

A Yes.

Q And they have done that all at the cost of the Royalite Company?

A Yes.

Q When it comes to another refinery they say "No, we will not give you that service but we will let you tap the line at your own expense and you do the connecting yourself out of your own pocket"?

A Yes.

Q If the general practice is that that service is given out of the rate, and they will not give it to this particular individual, should we reduce the rate by a corresponding amount or some amount?

A No, I think not. It would be my opinion in that case that the rate ought to be just the same because of this fact, in order to make these deliveries to these other refineries it is necessary that that main line be in. In other words,

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the whole mainline is a part of that service and if they had been to the expense of tapping the line and laying a line to their own refinery then they must stand their fair proportion of that mainline expense regardless of the fact that they are only actually using a portion of the mainline. If the mainline were not in there they would not have that service because it would not be economically sound to run a line for a small amount of oil.

Q I have got that point, Dr. Boatright, but I was going a little further, should they get some allowance for this connecting line if the refinery as distinct from the pipeline has to put up that capital?

A No, no. Not in the connecting line, you mean in that capital structure, that is the little refinery builds the line attaching on to their mainline?

Q Yes?

Q And your question now is, should that be charged into the capital for rate-making purposes of the Royalite Oil Company, is that your question?

Q No, my question is is that not a service that the Royalite Oil Company should give in the pipeline rate?

A No.

Q Without any extra charge?

A No, I think not.

Q Although they do it for the Imperial?

A They do it for the Imperial because of the peculiar circumstances, but they might just as well go into their own tank farm and then pipe to the Imperial. Now, there is the pipeline goes from Turner Valley to Calgary, that is the line, whether it goes to the Imperial or to their own tanks.

THE CHAIRMAN: They are their own tanks because they are paying $35,000.00 a year for it.

A As it is now, but I do not think that is right, as things are now, but, nevertheless, the pipeline extends from Turner Valley to Calgary, that is the line which is in, and it is necessary for the transportation of oil. Even although you tap on the line down here a mile or two miles or ten miles or twenty miles, it is all the same. The pipeline rate is based upon that length of line from Turner Valley to Calgary and it does not seem to me that a rate, a reasonable rate, or the rate that would be set up, should be made to include the necessary expenses which would be involved in connecting any other refineries which might happen to spring up along the route.

Q MAJOR LIPSETT: Although they do that service in Turner Valley, for the wells?

A For the wells, but that is part and parcel of their pipeline system.

Q THE CHAIRMAN: And part and parcel of their pipeline rate?

A That is right.

Q That gathering is not a separate part of it?

A No.

Q Presumably it is included in the rate they charge for transportation?

A Yes, that is correct.

Q MAJOR LIPSETT: Then if it is provided at the Calgary end free for the Imperial, why should it not be provided free, in your opinion, for this other refinery?

A For this reason, pipelines covering anything,-in this particular case it covers 35 miles, and a refinery might

spring up at any distance from that line over any part of that 35 miles; where their gathering lines are in that field, they are limited to the confines of the field and there is a definite limit put on them, but along the rest of the line there is no limit and a refinery might spring up right along the line or it might spring up two or three or four or five or ten miles from the line. In that event, they would be forced to make the expenditure, whether or not it was economically sound. In other words, it would throw the responsibility of whether the refinery would be operated or not, the responsibility would be on the refiner himself, the man who is going to put the money in. If the other way round was adopted it would put the pipeline at the mercy of every individual who wanted to go into the refinery business.

Q Should he not get something out of the pipeline rate to recompense him for that?

A I think not. That is an inherent part of the hazard of putting in his refinery. He knows where that pipeline is and he knows how much it will cost to lay that line and the tankage necessary to serve his refinery, and that is the information which the pipeline company would not have.

Q Well, on this question of distance there is a rate, I understand, I do not think I have got it, however, there is a rate of 7½¢ for delivering somewhere around Turner Valley at the present time, is there not?

A Oh, that is to local gas stations.

Q Yes?

A And is within the Imperial Company itself.

Q That is on the principle that a lesser charge is made where

the oil and naphtha goes a shorter distance?

A Yes, that is true, but I am under the impression that that is a separate line entirely from the other operation; in other words, that is a company operation within the company itself and, as I understand it, uses a separate line.

Q No part of this line?

MR. NOLAN: No part of this line.

Q MAJOR LIPSETT: Then it does not help us any?

A No, that is just a matter of another pipeline.

Q MR. FRAWLEY: Dr. Boatright, Mr. Coultis has put a line up to the Home-Millarville well from his No. 1 Tank Station, how many miles is that, Mr. Coultis can, perhaps, tell us.

MR. COULTIS: About 6 miles.

WITNESS: About 6 miles, I thought.

Q MR. FRAWLEY: Would that same kind of line do to serve Mr. Plotkins' refinery?

THE CHAIRMAN: We do not know yet that there is a line in.

MR. FRAWLEY: Perhaps Mr. Nolan will make a statement.

MR. NOLAN: Yes, it is in, my lord.

Q MR. FRAWLEY: Assuming that the Royalite Oil Company..

Q MAJOR LIPSETT: Is that put in as just part of the system, Mr. Nolan, and included in the 15¢ rate?

MR. NOLAN: Yes, Mr. Commissioner, it is an extension of the gathering system of this pipeline operation, to include the Home-Millarville well.

Q MR. FRAWLEY: And let us understand, no separate charge, the Home-Millarville Company pays the same, or suffers the same deduction; in other words, it costs the same to them as it does to the closest well to the No. 1

Tank Station?

A Yes.

Q We discussed this the other day, these are all pooled, but for the purposes of comparison, would that same kind of line do to take Mr. Plotkins' oil from the main trunk line to his refinery?

A Well, I do not know that it would be necessary to use the same sized line, in fact I do not know what the size of the line, what sized line is run out there, I understood it was 4 inch but I am not sure about that. In other words, it would be a pipeline, whether it would be 2 or 3 or 4 inch diameter line I cannot say.

Q Would it be.....

A It would be a pipeline and possibly of comparable length, but I do not know the distance of the Plotkins refinery.

Q Of comparable size, you mean?

A Yes.

Q In one instance the Royalite Oil Company absorbs that in the 15¢ rate, that is in the gathering line, even although it is more expensive to take it from a further well like the Home-Millarville well than from the closest well, but on the other hand, you say at the refinery end that they would be justified in asking the refinery to build the service line at its own expense?

A I believe they would.

Q THE CHAIRMAN: Since we have branched into this Plotkins matter, supposing the line is tapped and all the necessary fittings are done at the point of tapping, does that involve anything in maintenance and safe-guarding in the way of costs to the pipeline company?

A Well, strictly speaking, it should not, practically it does

because it is an inherent part of their pipeline system. In other words, their line walkers would have to go over that section too because if there is any loss occurs it is certain that the pipeline company would have to stand it until they got it to the point where they could gauge it into the tank.

Q Yes, and looking after those valves and things at the point of connection, that means something too?

A Yes, additional.

Q Then there must be, I suppose, a man who takes measurements at these refineries?

A That is right.

Q Representing the pipeline company?

A That is right.

Q So that it does mean some expense to the company?

A Yes, it does, which could be used to off-set that additional length of line from that point in.

Q Yes; now, having regard to this existing volume taken by Plotkins, would that justify them absorbing that expense?

A I think that that is something which they are certainly entitled to, in other words, they are entitled to get that additional expense back, taking this over and above what it otherwise would be, from Plotkins or whoever that refiner happened to be.

Q Yes?

A They are certainly entitled to that regardless of who makes the capital expenditure.

Q Just one other thing. I think in fairness it should be cleaned up, you reverted to Mr. Link's time of two years certain and three years probable; of course, it is right to

say that he has not denied that there may be many more acres of oil producing land?

A No.

Q To give the life of the field a very much greater time than he is prepared to estimate with reasonable certainty?

A That is correct, sir, if I made any statement that indicated otherwise I did not intend to.

MR. FRAWLEY: All right, thank you very much, Dr. Boatright.

Q MR. FRAWLEY: Just a moment, you spoke about, you made a comparison a moment ago of the percentage valuation as against the original cost, as Mr. Morrison had used?

A Yes.

Q There is this much which might be brought to your attention, if you have not discussed it already, these conditions when the line was constructed may be very different from what they are now, the percentage of labour costs may be very high as against low labour costs at the time the line was built, and the reverse also might be true?

A Yes, that is absolutely true. The method which I advocated and which Mr. Morrison used, takes into consideration the actual cost at the time the line was constructed, and in the case of lines purchased outside the company, purchased from outside companies, it only includes the actual cost or the actual amount which was paid for that line. Now, that will account for some differences between the percentage evaluation and any valuation arrived at by the basis which I suggest.

Q At least the method Mr. Morrison has used deals with actual facts and cannot be either fair or unfair to the company? y

A It deals with actual cash outlay.

THE CHAIRMAN: You say it cannot be fair or unfair?

Q MR. FRAWLEY: It cannot be unfair, whereas the other method, quite so, the percentage valuation might be fair or unfair to the company?

A Well, I do not know that I can answer the question in the form which you give it, but it means this, that the method which I advocated takes into consideration the actual cash outlay that that property represents whereas the other method involves an estimation or the present worth of that, regardless of the cash outlay.

Q That is what I mean; in other words, it may have been that the, at the time this line was built it may have cost a great deal more than the figure which Mr. Hill is putting on it now?

A That is right.

Q And that would not be fair to the company, and the percentage of reproduction cost may be a great deal less than it cost to put in and that would work the other way?

A Yes.

MR. FRAWLEY: All right, thanks, Dr. Boatright, that completes your evidence.

Q THE CHAIRMAN: Supposing, by reason of fire or explosion or something of the sort, this pipeline had become much less valuable than it otherwise would have been, would there not be an advantage in the percentage valuation as distinguished from cost?

A Well, no, I think not. Of course, we could take any number of conditions concerning the individual pieces of equipment or an individual item or a group of items and pick flaws in any particular method, but as an over-all thing it seems to me that the method which I am advocating is as fair as any method that could be adopted. For this

reason it these assets were badly damaged by fire and in an unserviceable condition, the chances are they would be taken out of the system and would not be included in my estimate at all. If they were in condition or if they were damaged but not damaged sufficiently to take out then they would be repaired and put in serviceable condition, and those charges in turn would be reflected in the operating cost, and the condition, so far as the plant as a whole is concerned, would then be the equivalent to what it would have been if the fire had never happened.

Q The company would suffer as a result of having that extra operating cost?

A That is right, and that would have come out of the profit for that particular period and would be reflected in their operating cost for that period.

MR. FRAWLEY: That is all. I will recall Mr. Morrison.

MR. NOLAN: I am wondering, sir, whether the time has come when Mr. Hill might give evidence. I know Mr. Frawley does not want to interrupt Mr. Morrison, but poor Mr. Morrison has been interrupted before. I am in a difficulty about Mr. Hill, which I need not go into, but I am anxious to get him on, and I am wondering if for the convenience of the Commission, we have now been discussing more or less the practical problem of the pipeline operation, and I am wondering whether it would not be useful to go on with that discussion, because that is all it amounts to, by taking the evidence of Mr. Hill at this moment. Of course, I am in the hands of Commission counsel and whatever is decided I am, of course, quite willing to comply with, but its usefulness at this stage, as against the accounting, seems to me to have some merit, and its usefulness at this stage might appeal to the Commission. If the Commission

feels it would like to go on now with this practical question arising out of the pipeline operation, and leave the accounting to come in a little later. It is quite obvious that we are not going to finish this week, and there is an anxiety on my part, and I am sure on Mr. Frawley's part, to conclude some of the evidence as quickly as possible.

THE CHAIRMAN: You, of course, cannot tell how long the examination of Mr. Hill, other than by yourself, will take?

MR. NOLAN: No.

THE CHAIRMAN: How long will you be?

MR. NOLAN: Well, he will take, we think, about two hours to explain his report and the contents of it. If he could begin to-day, it might leave to-morrow for discussion and cross-examination, in which event he might go back to the place from whence he came to-morrow night. My difficulty is that he came before and was not reached and stayed with us, then went back and now he has come again.

THE CHAIRMAN: Mr. Frawley?

MR. FRAWLEY: Of course, it is not only a matter of interrupting Mr. Morrison, because I take liberties with Mr. Morrison, but it is interrupting the case, and that is the difficulty.

MR. NOLAN: There is no case.

MR. FRAWLEY: No, but I am trying to present, I am going some place, strange as it may seem.

THE CHAIRMAN: So long as no one cuts you out.

MR. FRAWLEY: Yes, but, of course.....

THE CHAIRMAN: After all, you are generally engaged in the case and this is quite understandable.

MR. FRAWLEY: Yes, I might be excused, but I have a certain bit of evidence to present, and likely Mr. Nolan has too, because it is very much of a fiction to call Mr. Hill my witness. He is, of course, but I just show that he is and then I am done with it, but I have witnesses here that I have briefed, that is why I say I am going a certain place, and then I am through. I realize Mr. Hill has been here, and Mr. Hill is a man whose time is certainly valuable, and I want to help.

THE CHAIRMAN: You interjected Dr. Boatright on matters which were not strictly accounting, and I do not know, Mr. Frawley.

MR. FRAWLEY: Yes.

THE CHAIRMAN: And he has dealt with the very subject that Mr. Hill will speak upon. Mr. Hill comes from afar and Mr. Nolan's request is not unreasonable.

MR. FRAWLEY: No, I do not think it is unreasonable but I was wondering if it was unreasonable to you,..... Commissioners, because you are going to have to start off......

THE CHAIRMAN: We cannot be much more confused.

MR. FRAWLEY: That is all I was thinking of.

THE CHAIRMAN: All right, we will hear Mr. Hill, but we might at this point take five minutes' recess, so that he can be prepared.

(A five minute recess was here taken.)

....

THE CHAIRMAN: Mr. Nolan is tendering an exhibit, I understand?

MR.NOLAN: If I may I am going to tender as an exhibit the Report of Ford, Bacon & Davis, dated December 31st, 1938, as Exhibit "96".

DOCUMENT IN QUESTION IS NOW MARKED AS EXHIBIT "96".

MR. FRAWLEY: There was one matter which I should have asked Dr. Boatright.

....

DR. BOATRIGHT, recalled:-

Q Dr. Boatright, what has Mr. Morrison done in his accounting in the matter of salvage of the pipe line?

A He has deducted 10% from the value of the capital investments, where the life has been assumed up to 15 years, and beyond 15 years a figure of 5% has been used as being the reasonable salvage value, at the end of the life of the pipe line.

Q In other words, if the Commission takes a life of 15 years or under, Mr. Morrison's allowance is what?

A 10% for salvage.

Q And that is dealt with at Page 5 of his Report. Perhaps the quickest way might be to read his Page 5. Mr. Morrison says:-

" A salvage value of 10% has been deducted
"from the assets when arriving at the annual
"charge for depreciation on the bases of life-
"times of from five to fifteen years, and

"5%.salvage value on the bases of life-

"times of from twenty to thirty years."

What are your views about that?

A I feel those figures are reasonable.

Q Thank you very much.

MR.NOLAN: Nothing thanks.

....

EDGAR G. HILL, having been duly sworn, examined by Mr. Frawley, testified as follows:-

Q Mr. Hill, where do you live?

A I live in Larchmount, New York.

Q And what is your business?

A I am a Consulting Engineer.

Q Will you put your qualifications on the record, Mr. Hill, so that we will have them?

A I am Vice-president and a director of the New York engineering firm of Ford, Bacon & Davis Incorporated. I was graduated from Yale University in Mechanical Engineering in 1904. For the next 15 years I was engaged in the machinery business, as engineer in the shop and in the drafting office, and finally in the sales end of the business. In the year 1908 I went in the Natural Gas and Oil business in South Eastern Kansas with my uncle's firm, the Southwestern Gas Company. There I acted a Chief Engineer and General Superintendent.. In 1920 I was borrowed by Ford, Bacon & Davis to help them in an engineering appraisal of natural gas properties of several large utilities, serving the cities of Pittsburgh, Cleveland and other cities in Ohio and Pennsylvania. I

Edgar G. Hill

had charge of that work before it was finished, and after it was finished I was asked by Ford, Bacon & Davis whether I would care to join their staff, and I did. In 1923 I was sent to Edmonton, Alberta, to build and operate a natural gas system there, which is known as The North Western Utilities Limited. I acted as President of that Company during the years 1933 and 1934, being succeeded by the late C. J. Yorath. I put that system into operation and then returned to the United States, to my firm. In 1925 I went to Louisiana and for the next two years I was engaged in designing and building what was then the largest natural gas line ever built. A twenty-two inch pipe line, 170 miles long, from the Northern Louisiana gas field to the City of Baton Rouge, and thence 80 miles of 18 inch gas line to the city of New Orleans. I built those properties and operated them, set up the operating organization, and in 1938 I went to Colorado and designed and built and put into operation the natural gas system extending from the Northern Part of Texas to the City of Denver, which at that time was the largest natural gas system ever built. When that work was finished in 1929 I went to Birmingham, Alabama, and put into operation the natural gas system extending from Northern Louisiana to the cities of Birmingham and Atlanta, which at that time was the largest natural gas system ever built. After that I acted as Vice-president and General Manager of that Company, and got its operating organization going and returned to New York in 1931. Since that time I have been actively engaged

in consulting engineering and management work in the oil and natural gas business. My firm is one of the larger New York engineering firms, and has a considerable volume of consulting, construction and management work in oil and natural gas. That department I am the head of. My work has taken me to all parts of the United States, excepting the Pacific Coast, where oil and gas is found, and also into this country. In December of 1938 I was asked to assume the Presidency of the National Refining Company, which is one of the larger minor integrate oil companies in the United States. I am now President of that Company, but not having severed my connection with Ford, Bacon & Davis. Previous to assuming the Presidency of that Company, I had, for my firm, made a complete study of its operations and business, and reported to the Directors on its operations and business. I have from time to time appeared before Courts and Commissions in this country and the United States, including The Public Service Commission of Alberta, the Public Service Commiss[illegible] of New York, Pennsylvania, Ohio and West Virginia, Alabama, Louisiana and the Securities and Exchange Commission at Washington, and before various Courts and Special Masters, in matters having to do with Oil and Gas work. I am not a professional witness. In May of last year I was asked to make a study and report on the property and business of the Royalite Oil Company Limited, Pipe Line Division. I came to Alberta in May, made such a study, which I later brought up to date last month.

[illegible]

[illegible] and functions [illegible]

[illegible]

Edgar G. Hill

Q THE CHAIRMAN: This Report you made in May was made to the Royalite Oil Company?

A Yes, it was to the Royalite Oil Company, and was later brought up to date and forms now the report you have in front of you.

Q MR. FRAWLEY: Have you got the Report, Mr. Hill, that you made to the Royalite Oil Company in May or June or July?

A I have a draft of it here, yes.

Q And that Report was in the hands of the Royalite Oil Company for quite some time?

A I believe so.

Q And as I understand you got it back from them?

A I took it back and Mr. McLeod asked me to bring it up to date for the benefit of the Commission here, to bring it up to end of December, which I did.

Q And your present report is dated December 31st, 1938?

A Yes.

Q But you have a draft of your earlier report?

A I have.

Q I think we had better have that marked as an exhibit for what it is worth.

MR. NOLAN: There is no objection?

A No objection.

Q MR. FRAWLEY: Is it with you?

A No, I will bring it. It is in my room at the hotel, but I will bring it when I come back from lunch.

Q All right, thanks. Then Mr. Hill, would you answer Mr. Nolan's questions.

Q MR. NOLAN: I wonder, Mr. Hill, if you would be good enough for the benefit of the Commission to read to them the Report which you have prepared

Edgar G. Hill.

and which has been marked Exhibit "96". We think that is as good a way of doing it as any, if it meets with your approval?

A I will read the letter of transmittal which forms Page 1 of the Report, first. That is dated New York,

"

ESTABLISHED 1894

(COPY)

FORD, BACON & DAVIS
Incorporated

ENGINEERS

CONSTRUCTION VALUATIONS REPORTS MANAGEMENT

NEW YORK
PHILADELPHIA

CHICAGO
DALLAS

39 BROADWAY
NEW YORK

New York, December 31, 1938.

Royalite Oil Company, Limited,

Calgary, Alberta, Canada.

Dear Sirs:

Pursuant to instructions, we have made a study of the property and business of the Pipe Line Division of your Company, including a valuation of its physical properties and business, and a calculation of its probable near future earnings under the tariff which it now charges for the transportation of naphtha and crude oil from the Turner Valley field to Calgary.

It is our opinion that the property and business of the Pipe Line Division is conservatively worth at least $1,700,000 at the date of this report.

We are also of the opinion that the current tariff of 15 cents per barrel is reasonable, considering

Edgar G. Hill

the risks and uncertainties inherent in the business of the Division.

The details and reasoning on which these conclusions are based will be found in the attached report.

Very truly yours,

(Signed) FORD, BACON & Davis, Inc."

I might say here that I wrote this report myself, but that in our firm the individual cannot sign reports and they are signed with the firm name. The opening paragraph of the report, the text of the report is Nature and Location of Operations.

" Nature and Location of Operations.

This Division operates a gathering and transportation system for crude naphtha, absorption naphtha and crude oil in the Turner Valley field, Alberta, Canada. It gathers crude naphtha and crude oil from producers' tanks at the wells. Absorption naphtha is received at two absorption plants of Royalite Oil Company, Limited, and at one absorption plant of British American Oil Company, Limited.

Delivery of crude oil is made into rented tanks at the Imperial Refinery at Calgary, located about 35 miles from the center of the oil field. Naphthas are delivered direct to the refinery.

.. DESCRIPTION OF PROPERTY

Gathering System.

The gathering system of the Division comprises 72 miles of 4 in., 3 in. and 2 in. pipe, of which 0.4 miles are at present inactive. It also includes 73 pumps

located at the wells and absorption plants and two field pumping stations which deliver the oil to the trunk line storage tanks at Turner Valley. The system is shown in detail on the map appended to this report."

The map in the report is on a very small scale, it shows on Page 59, and shows the Gathering System, the location of the Pump Stations, the location of the Absorption Plants and so forth. There are maps here from which this map was made, which are on a very much larger scale, and which I can refer to at any time as I go further along with the text.

"Storage Tanks.

A tank farm at Turner Valley, owned and operated by the Division, contains crude oil and naphtha storage tanks of a total capacity of 118,380 barrels. In addition, two tanks of 10,000 barrels capacity each are located at the field pumping stations.

Main Pumping Station.

At Turner Valley the Division owns and operates a pumping station which draws the naphtha and crude oil from storage and delivers it into the trunk pipe lines which extend from the field to Calgary. This station is new. It contains three multiple cylinder 200-horsepower (see level rating) gas engines, each driving a 5-1/2 x 18 vertical triplex single acting power pump capable of operation against a pressure of 1,000 pounds per square inch. Normally two units are assigned to crude oil service. One unit operates on either crude or naphtha, as required.

Edgar Hill

Trunk Pipe Lines.

These are three in number; a 4-inch welded line (No.1), built in 1925 but completely reconditioned during the last four years; a 4-inch welded line, (No.2), part of which was built in 1929 as a victaulic coupled line but was completely rebuilt as a welded line in 1937 and about 7 miles of new line added, and a 6-inch welded line built in 1937 and 1938. These lines are all protected with an asphalt coating, lines Nos. 2 and 3 being wrapped and a second coat of hot asphalt applied over the wrapper. Line No. 1 is similarly protected in many places. The lengths of these lines are as follows:-

Line No. 1	154,603 feet	(29.3 miles)
Line No. 2	165,499 feet	(31.3 miles)
Line No. 3	166,604 feet	(31.6 miles)

Lines Nos. 2 and 3 follow approximately the same right-of-way. Line No. 1 is laid on a right-of-way owned jointly with the natural gas company serving Calgary. The location of the lines is shown on the appended map."

That map forms Page 60 of the Report, and whilst it is on a small scale I think it is quite clear. I do not think there are any other large scale maps necessary, although I believe one is available.

Capacity of Trunk Pipe Lines

The three pipe lines have an aggregate daily rated capacity of 24,000 barrels, with a maximum capacity of 28,000 barrels. Lines Nos. 2 and 3 are normally operated on crude oil at 1,000 pounds station pressure. Line No. 1 normally operates at 750 pounds

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pounds station pressure.

Other Property.

In addition to its field gathering lines, field pumping stations, storage tanks, main pumping station and trunk pipe lines, the Division owns four employe's dwelling houses in the field, a field office, a field warehouse and shop, a foam house at the tank farm, several automobiles and trucks, several items of pipe line construction equipment, furniture and fixtures in its field office and in the offices it rents in Calgary, and certain miscellaneous structures and equipment items, all of which are set forth in detail herein.

Age of Properties.

The property for a great part is new, or substantially so. With the exception of part of the gathering system, the pipe lines of the Division either have been built new or wholly reconditioned within the last five years. Its pumping stations are new in 1938. Some of the equipment at the new field stations has been used previously in the former main station and elsewhere.

The tankage is not new but several of the larger tanks have been rebuilt recently and are apparently in a condition substantially equal to new.

Condition of Properties.

The pipe lines and pumping stations were carefully inspected by the Engineers in May and December 1938 for the purpose of determining the physical depreciation which had accrued in them. The gathering system pipe

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was exposed at 48 separate locations and carefully cleaned and inspected. Several nipples were cut from the lines to reveal what internal corrosion, if any, had occurred. These inspections disclosed a high state of maintenance with very little external corrosion and no internal corrosion.

Fifteen similar inspections were made on the trunk lines, most of them being made on the two older lines. Line No. 1 was found to be in remarkably good condition and lines Nos. 2 and 3 were in a condition practially equal to new. It was evident that the soil in which these lines are laid is not particularly corrosive to steel pipe well protected by an asphalt coating, particularly where a wrapper is used. These inspections were made in May 1938.

The pumping stations, all of which had been built in 1938, were likewise in a condition practically equal to new.

Most of the structures, except the four dwelling houses and the field office, were built in 1938. The dwellings and office were well maintained.

The principal items of automotive and construction equipment were likewise either of 1938 or 1937 model and in very good condition. Furniture and fixtures in the offices were bought new in 1938.

There may be more depreciation present in the storage tanks than can be disclosed by outside inspection. The tanks are well kept up and from the outside appear almost equal to new. It was not practicable to make an internal examination or

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to drill holes in the tank plates. For that reason, and for the further reason that most of the tankage was not new when installed at present location, physical depreciation of 20 per cent was assumed to exist in the crude storage tanks and 30 per cent in the naphtha storage tanks."

(Go to Page 2465).

(EXAMINATION OF THE WITNESS EDGAR G. HILL CONTINUED BY MR. NOLAN)

WITNESS: Shall I proceed.

Q MR. NOLAN: Yes, I think you were reading on page 8, Mr. Hill.

MR. FRAWLEY: Mr. Hill has not the draft report or the report, the earlier report which we were speaking of this morning.

THE CHAIRMAN: Oh yes.

MR. FRAWLEY: I offered it. It is a report, the Royalite Oil Company Limited pipeline division as of May, 1938, dated May 25th, 1938.

WITNESS: That is the only copy I have, Mr. Frawley. I think there are one or two in New York but that is the only copy I brought along. It is yours to do with as you see fit.

MR. FRAWLEY: Well it will go in too, it will be marked as an exhibit, Mr. Hill, and presumably when the Commission's work is finished and they have no further use for it, it can be given back to you.

A It doesn't have to, I have another copy but it is the only one I have here.

(COPY OF REPORT DATED MAY 25th, 1938 PRODUCED BY THE WITNESS HERE MARKED AS EXHIBIT 97".)

THE CHAIRMAN: That is the report of May 1938.

MR. FRAWLEY: Yes, and it is dated May 25th, 1938. The letter of transmittal is dated "New York, May 25th, 1938".

THE CHAIRMAN: It is part of the report which is now Exhibit "97"?

MR. FRAWLEY: Quite.

Q MR. NOLAN: Will you go on from where you were?

A I think I was at the top of page 8.

" INVENTORY METHODS

The inventory of pipe, fittings and valves was taken by employes of the Company from actual measurement and count in the field. The Engineers in their inspection of the property were able to check this inventory to a considerable extent. They did not, however, actually measure any of the pipe lines on the ground.

The inventory of pipe lines was taken for each section of land separately, making it a simple matter to check the inventory by scaling the line lengths on the maps on which they are recorded. The Engineers spot-checked the pipe line inventory in this way.

The inventory of machinery, buildings, tanks and other items of property was made by Company employes, but all such items, with insignificant exceptions, were inspected and checked for existence and condition by the Engineers.

VALUATION OF PROPERTY

A valuation of the property of the Pipe Line Division as it existed on December 31, 1938 was made by the Engineers, using material and labor prices current in the territory as of that date. Prices used for pipe were those applicable to carload lots. Prices for principal items of equipment were taken from Company vouchers, as most of these items had been purchased recently. Quotations on tanks were obtained from a local representative of one of the principal manufacturers."

MAJOR LIPSETT: Are those all new prices, Mr. Hill?

A Yes, new prices. You see 60% of the property has been built in the last two years.

"Land

The land included in this valuation comprises five lots in the Royalite townsite at Turner Valley on which four employes' dwellings and the field office are located, the land at Turner Valley occupied by the storage yard and shop, together with that occupied by the pumping stations, as well as the tank farm land at Turner Valley. A valuation of $2,437 was placed on this land (which comprises 36.04 acres) as follows:

5 Lots (2.14 acres)	at	$250 per lot	$1,250
33.9 Acres	at	35	1,187
		Total	$2,437

Rights-of-Way

The trunk pipe lines are in part located on private rights-of-way and in part on public road allowances. The actual cost to the Company of its one-half interest in the private rights-of-way occupied by trunk pipe line No. 1 was $5,124. The Company has no record of the costs of the rights-of-way on trunk pipe line No. 2 as most of this line was purchased in place as a unit. Rights-of-way costs on line No. 3 are not yet complete.

Some of the gathering system pipe lines occupy rights-of-way jointly with the natural gas and water pipe lines of the Producing Division of the

"Company and no allocation has ever been made of their cost as between the Producing and Pipe Line Divisions. Some of the gathering system lines are likewise located partly on public road allowances.

After consideration of the location and length of the lines a valuation of $16,196 was placed on all of the private rights-of-way applicable to the pipe lines covered by this valuation, which is believed to be a reasonable figure, having in mind present-day costs of rights-of-way in this area.

Structures

The four employes' dwellings were valued on the basis of actual cost of a similar dwelling recently built in the townsite. The actual costs, either complete or partial, were available for the other structures and formed a basis for the valuation.

Pumping Stations

The trunk line pumping station No. 1 at Turner Valley and Stations Nos. 2 and 3 in the field were recently completed. Cost records were available and were used as a basis for the valuation of these stations.

Pipe Lines

The Company furnished the Engineers with actual costs and recent cost estimates on several of the lines recently laid. These together with the cost experience of the Engineers in the construction of similar property, formed the basis of the estimates herein.

"   Trunk pipe line No. 3 was constructed largely during the winter months. The Engineers in making their valuation assumed that the pipe lines would not normally be constructed during the winter when installation costs are high, and for this reason the actual book cost of trunk pipe line No. 3 will be found to exceed the estimated cost used in the valuation for this particular line.

About 4 miles of the gathering system were not fully completed at the date of the valuation, but were so near completion that they have been included in the valuation at their estimated cost when completed."

WITNESS: Now with reference to the whole Millarville line and another, a replacement being made in another line which also serves the Home-Millarville, those replacements were all completed by the 31st of December, 1938.When I was on the ground on the 15th of December they were not quite completed so I took them in as completed at December 31st.

"Summary of Valuation

The valuation of the physical property of the division as of December 31, 1938 is summarized as follows:

WITNESS: And here I classify the various accounts and on the right-hand side of the page I have two columns under the heading "Estimated Cost of Reproduction as of December 31, 1938". The first of those two columns, the one to the left, is headed "new"; the one

to the right "Less Depreciation". That means that the figures in the "new" column are my estimates of the cost to reproduce the property "new" at December 31st, 1938. The column to the right is my estimate of that cost less the money value of the physical depreciation which I found to have had accrued in those various items of property at December 31st, 1938. The total, before working capital and materials and supplies, is under "new" column $1,539,226.00; under the "less depreciation" one is $1,434,244.00.

For working capital for material and supplies---

Q THE CHAIRMAN: What is your total there?

A $1,434,244.00.

Q Oh yes.

A You see 60% of this property is practically new.

Working capital for material and supplies, I have allowed $80,000.00 as being in my judgment a fair allowance for cash, small tools, material and supplies which this company, this division, would need for its operations were it a separate corporate entity. That makes my total valuation of the physical property and working capital, "new" $1,619.226.00; less depreciation $1,514,244.00; that means in my opinion there has accrued in this property almost exactly $105,000.00 of actual physical depreciation. Those totals include an allowance of general overhead costs which have not been taken into account in the unit costs of the various items of property.

"General Overhead Costs

These are the undistributed general overhead costs unavoidable in the construction of a property of this type which have not been provided for elsewhere

"in the valuation. They include costs of preliminary investigation of the project, the costs of administration, legal expenses and taxes during construction, costs of engineering design and supervisision of the project during construction, interest during construction, and costs of injuries and damages claims incurred during construction which were not covered by insurance. In total these have been estimated at 10 per cent of the costs of the physical property, based on a construction period of one year.

Working Capital

The total expenses of the Division for operation and maintenance for the 12-months period ending June 30, 1939 are estimated to approximate $311,500. One-eighth of this amount, or $38,900, is believed to be a reasonable cash working capital for the Division.

The Division does not carry much stock of materials and supplies other than repair parts for machinery, pipe fittings, small tools, etc. It is free to call upon the main warehouse of the Company for any of its requirements, consequently the amount of materials and supplies shown on the Division's books is not a fair criterion of its reasonable needs.

In the experience of the Engineers the Division, if it were entirely divorced from the parent Company, would normally carry an inventory of spare parts, pipe, valves, fittings and small

tools of $40,000 to $50,000. The total normal working capital requirements of the Division would, therefore, range between $78,900 and $88,900. A total of $80,000 for working capital has been used by the Engineers as representing a reasonable average allowance.

Value as a Going Concern

The Pipe Line Division of the Royalite Oil Company, Ltd. is a going concern which has been in successful operation for more than ten years, although it has been considered as a separate Division of the Company only since January 1, 1938. It is the principal gatherer and transporter of crude oil and naphtha in the Turner Valley field. Its property is well maintained and efficiently operated by experienced men all of whom have had many years of service with the Company.

In the opinion of the Engineers the small amount of physical depreciation found to exist in the property does not measurably detract from its service value.

The Division receives the benefit of the utility services such as electric power and light, water, steam, sanitation and repair shop facilities provided by the parent Company at Turner Valley. While a proportion of the operating expenses of these utilities has been allocated to the Division, the Engineers have not attempted to allocate to the Division any of the parent Company's investment in these facilities. If they did not exist the Division would have to pro-

vide them and their cost necessarily would be included in any valuation of the Division. The investment of the parent Company in these utilities is substantial, approximately $1,000,000.

For all of these reasons the Division has, in the Engineers' opinion, a value as a going concern which is in excess of the depreciated value of its physical assets plus working capital. This value as a going concern, necessarily a matter of judgment, is fixed by the Engineers at a minimum of $1,700,000 at December 31, 1938."

WITNESS: The next heading on page 16 is entitled "Tariff, volume, gross income, operating expenses, amortization of Capital and probable near future earnings."

" The Company's present tariff for the gathering of crude oil, crude naphtha and absorption naphtha from the run tanks at the wells and from the absorption plants in the Turner Valley field and transportating it to and storing it in the receiving tanks at the Imperial refinery in Clagary, is 15 cents per barrel of 35 Imperial gallons. (Naphthas are not stored but are delivered direct to the refinery). At an average daily rate of 15,000 barrels, the annual volume handled will approximate 5,500,000 barrels which is believed to be a reasonable estimate for the next two or three years, assuming that no substantial new discoveries of crude oil are made in the Prairie Provinces. At this tariff and volume the resulting annual gross income of the Division will be $825,000. In addition the Division makes a deduction of one per cent of the crude oil handled

"and two per cent of the naphthas handled, which deduction is calculated to compensate the Division for gathering, storage and transporation losses.

In the first nine months of 1938 the actual losses of this nature amounted to 0.52 per cent of the crude oil handled. If this ratio continues the indicated net profit to the Division from this one per cent deduction will be $33,000 per year, based on crude at $1.25 per barrel. The volumes of naphtha transported are so small that any profit or loss resulting from the two per cent charge is considered negligible. In the year 1937 the crude deduction was two per cent and the actual crude losses were .98 per cent."

WITNESS: There is a correction which I made in all of the copies except yours, Mr. Frawley, .98.

MR. FRAWLEY: I have it corrected now.

THE CHAIRMAN: You say that is .98?

WITNESS: Yes, that was in 1937.

THE CHAIRMAN: I have it. .98.

"So that if the results for the years 1937 and 1938 are averaged, there would be less profit to the Division arising from the one per cent deduction. On the other hand, the volumes transported in 1937 were much less than in 1938 and as loss ratios of this nature tend to decrease as the volumes handled increase, it is probable that the profit to the Division from this source will continue at about the 1938 rate, barring serious line breaks or fires. The annual gross income of the Division is

"therefore estimated to be at the rate of $858,000 per year for the near future.

Operating Expenses

The operating expenses, including ordinary property taxes, for the Division for the first nine months of 1938 were stated to the Engineers by the Company's auditors, Messrs. Price, Waterhouse and Company, to be $214,488.69. This sum includes rental charges for the three large receiving tanks at the Imperial refinery for only 4-1/2 months of the nine months and likewise includes the operating expenses of the two new field pumping stations for only about 2-1/2 months, as these stations were not completed until the summer of 1938.

Ignoring these facts and adding one-third of the nine months' expenses results in a figure applicable to the entire year 1938 of $285,984.92. However, the Company's direct operating expenses for the month of November, 1938, as disclosed to the Engineers by the Company's Treasurer, amounted to $23,151.35 exclusive of the Division's proportion of indirect expenses and property taxes. On the basis of the November experience the Division's direct expenses would be running at the rate of about $277,800 per year, exclusive of depreciation, taxes, or any indirect expenses.

The Company's auditors fixed the Division's proportion of administration charges for the first nine months of 1938 at $13,871.58, arrived at by allocation on an operating labor basis, which is at

"the rate of $18,495.44 per year. The auditors also allocated certain portions of indirect operating costs of the entire Company, including utility service, depreciation on automobiles, trucks and tractors, and general corporate costs, to the Division in the amount of $59,109.25 for the first nine months, or at the rate of $78,812.33 per year. The sum of these three annual amounts is a total of $375.107.77. This figure doubtless contains some duplications of utility expense and is probably further distorted by reason of the apparently abnormal maintenance expense in the month of November.

After considering all these factors the Division's operating expenses for the 12 months ending June 30, 1939 have been estimated by the Engineers as follows:

Operating Expenses for the first nine months of 1938 as per Price Waterhouse & Co.	$214,488.69
Deduct: Tank Rentals included in above	14,583.30
Balance	$199,905.39 "

WITNESS: Which would be for the nine months without tank rentals, to which I add 1/3 for October, November and December.

"Add one-third to cover October, November, and December, 1938	66,635.13
Add: 12 months' Tank Rentals	35,000.00
Add: Allowance to cover full year's operating costs of new pump stations.	10,000.00 "

WITNESS: Because only two and a half months of those operations of those stations were included in the nine months' expenses that the auditors gave me. That

$10,000.00 includes the extra cost for operating those two stations, made up mostly of electric power which was purchased, labour and a small amount of material and supplies, which gives me a total of $311,540.52, or say for the twelve months ending June 30th, 1939, $311,500.00, which is my estimate of the total operating expenses of the division for the year ending June 30th, 1939

(Go to Page 2478).

"Probable Cost of Building and Operating
Extensions to Gathering System."

I may say here I am going into this because we are making a rate for the future and we have to take into account moneys the company will have to supply in the near future in providing additional construction.

" As the Turner Valley field increases in area the Division will be required to lay gathering lines to the new wells and install pumping facilities at such wells. At present 12 wells are being drilled in the field.

There is no basis for any exact forecast as to the amount of money which the Division will have to spend each year in the future for extending its system. The best that can be done is to make as rational an estimate as possible. It must be borne in mind also that, unless the total demand on the Turner Valley field's production increases, the bringing in of additional productive wells will result in less oil being taken from each well. The labor costs to the Division of gathering oil are largely proportional to the number of wells, so as the number of wells increases operating costs will also increase, even though the volume of oil handled remains the same.

In the opinion of the Engineers the sum of $125,000 per year is a reasonable estimate, on the average, of the additional costs both for construction and operation which the Company can be expected to have to incur in the future to provide connections to additional wells and meet the additional operating costs of handling them. Strict accounting practice would dictate that such part of this annual cost of $125,000 as is incurred for construction

be capitalized and added to the value of the property, and the remainder, representing estimated additional annual operating expenses, be charged to expense. The additional capital expenditure would, of course, be subject to amortization and the Division would be entitled to the same rate of return on it as on its present property. For convenience, however, the Engineers have treated this entire $125,000 estimated additional outlay as an expense item, recoverable in the year when incurred.

Amortization

Before net earnings of a property of this kind can be estimated there must first be deducted from gross earnings a reasonable provision for return of the capital represented by the value of the property. The Engineers have estimated the value of this property and business as a going concern at not less than $1,700,000. It is the judgment of the Engineers that during each of the next ten years a sum should be set aside out of income so that these sums together with interest thereon at the rate of 3.5 per cent per annum compounded annually will, at the end of ten years, equal such minimum value of the property, excluding working capital, less salvage estimated at 5 per cent, thus resulting in a complete amortization or extinguishment of the value of the property and business as now determined on December 31, 1948. The annual charge against income so computed is $131,186."

THE CHAIRMAN: Might I ask you to pause there, as I understand you, this line has been kept in first class condition?

A Yes, sir.

Q So that it is, to all intents and purposes, new, or practically so?

A Well, 60% of it is new, you might say; 40% has been built back as far as 1925, and 75%, I would say, has been built in the last five years.

Q In the result you have a line which is in first class condition?

A First class condition.

Q And is so maintained?

A Yes, sir.

Q And as a result of careful maintenance and reconditioning you are able to speak of it in the high terms in which you do to-day?

A Yes, sir.

Q Now, that maintenance and reconditioning has been treated as an operating cost, has it not?

A In part it has and in part it has not.

Q To what extent?

A As far as my $311,500.00 are concerned, I would say that that sum contains little, if any, cost of reconditioning. As to pipeline No. 1, which was reconditioned two or three years ago, I understand that those costs were charged to operating expense in that year. However, I did not take that year into account in my figure that I have used here.

Q MR. COMMISSIONER LIPSETT: Which year was that?

A I may say so in the report. I think I do. During the last four years the No. 1 line was reconditioned, in 1934, 1935, 1936 and 1937. To the best of my knowledge no expense was put on it in 1938, because I examined it in 1938 in May and there was no evidence of any work having been done on it recently. I think I am quite safe in saying that none of the costs of reconditioning the No. 1 line have crept into the $311,500.00 which I have set up here as my estimate for the future, the near future.

Q Was that four years' reconditioning done out of current income?

A It was out of the company's treasury, I do not know where they got the money.

Q THE CHAIRMAN: What has actually happened can, of course, be checked. What I would like to know from you is, you assert that a company is entitled to maintain and recondition as an operating cost and in addition get depreciation allowed to it?

A Well, it is not entitled to any duplication. That is if we charge our expense of reconditioning to operating expense we should not again capitalize that and take depreciation on that capital.

Q That is what I want to know?

A That would be complete duplication.

Q That is what I wanted made clear?

A I do not think that that has come in here, as far as any operating expense figures I have used. That is, I do not see how it could have . I will be glad to be enlightened if it appears to any one that has happened, but I am quite certain that it has not.

Q Whether it has happened, that is something that can be checked?

A Absolutely.

Q But I want to know what the principle is, you cannot charge something for reconditioning and maintenance and put it in as an operating cost and then also get depreciation on that thing so reconditioned and maintained?

A Not if you are using for any particular year an operating cost which contained the cost of that reconditioning. Those costs should be excluded, naturally, from your operating cost and not repeated, because you have already

capitalized it. You cannot handle it twice. You have either to capitalize it or expense it.

Q Quite so.

A The Engineers express no opinion as to the probable life of the Turner Valley oil field. This field has been a substantial producer of crude oil only for the last two years. Its development is probably only partially completed and it may become a field of major importance. The life of this field depends on many factors unknown and unpredictable at this time, such as its extent and productivity, the annual demand upon it, methods of production and the cost of recovering the oil as compared with costs of other crudes which may become competitive.

<u>Probable Near Future Earnings and Return</u>

With probable annual gross revenue of $858,000, near future operating expenses and property taxes estimated at $311,500, probable increased annual costs of $125,000 and provision for amortization of capital amounting to $131,186 annually, there will remain before Dominion and Provincial income taxes the sum of $290,314 on which Dominion income taxes of 15 per cent and Provincial taxes of 7 per cent are considered applicable, resulting in a combined income tax of $63,869. When these income taxes are subtracted there remains $226,445 representing the estimated annual net earnings of the business available to the owners thereof, which is equivalent to 13.3 per cent of $1,700,000, which is, in the opinion of the Engineers, a fair minimum value of the property and business of the Division at December 31, 1938."

THE CHAIRMAN: May I ask you to pause there, before we get on to a point that might have nothing to do with this.

I see you provide for $125,000.00, is it not, for increased expenditure in connection with gathering lines and the like?

A Yes, sir.

Q In the year that is to come?

A In any year.

Q In any year, yes. Have you set opposite that in any way or anywhere, you may come to it but I think not, that when they have to put down more gathering lines for new wells that the through-put will be increased and they will get greater profits?

A No, sir. The through-put will not be increased, in my opinion, unless the market in the Prairie Provinces for crude increases beyond the figure I consider likely. You see, these Provinces consume about 17,000 barrels of crude oil, or their products, a day. Until that market increases this company's system will not handle any more crude unless the crude is exported from the Province. I go on to say here I do not believe that is feasible at the present time. I think I have pointed out that as we drill more wells in Turner Valley, unless the market for this Province increases, the result will be that a smaller amount of oil is taken from each well. That is an obvious fact. Does that answer your question?

Q You say then that these new lines we put down will be necessary to supply the present market and no more?

A Oh, they would be able to supply more. But because these wells now are pro-rated to some extent, as we drill more wells they will have to be still further pro-rated because we have more possible potential available for pro-ration. That is, let us assume our wells were now being pro-rated 25%, and we doubled the number of wells, naturally it would take just half as much from the existing wells as we

are taking now. It means further pro-ration unless we increase our market.

Q Yes, I see. You are working on the basis of the same volume of through-put throughout?

A For the next two or three years. It happened when I was here in May I discussed that situation with people here whom I thought might know what the facts were, and they gave me a figure of 15,000 barrels a day from this field as being, in their estimate, a reasonable likelihood for the next few years on the average. You see, some oil is imported from the United States still, in the form of the finished product. It happened when I was here in December I heard testimony that confirmed this five and a half million barrels a year as being the likely average for the future. It happened in 1938 the Division handled about six million barrels. Whether that six million barrel through-put will continue in 1939 I do not know. It depends on many things. What I am using here is my estimate of the normal average demand on this system for the next two or three years, five and a half million barrels.

Q All right.

A Will I go on with the report and repeat what I have been telling you verbally? I will skip over that.

THE CHAIRMAN: You were going to read a statement?

A Yes, I will read the statement.

" .. This is expressed in statement form as follows:

"Annual Gross Revenue	$858,000
Operating Expenses and Property Taxes	311,500
Balance	$546,500
Provision for Increased Annual Costs of Construction and Operation	125,000
Balance	$421,500
Provision for Amortization of Capital	131,186
Balance	$290,314
Provision for Dominion and Provincial Income Taxes	63,869
Balance - Net Income	$226,445

equivalent to a return of 13.3 per cent.

Return Must Be Commensurate With Risk

On the face of the figures so far discussed this estimated return of 13.3 per cent on the minimum value of the property and business at December 31, 1938 might appear somewhat excessive when compared with the lower rates of return allowed by regulatory bodies on public utility properties serving electricity and gas. In the opinion of the Engineers, however, this return is fully warranted and justified by the risks inherent in the oil business.

In the United States, tariff rates on pipe line systems serving isolated fields are commonly calculated to return the investment in about three years. In the particular case under discussion it must be realized that there is no guarantee that the Division will handle 5,500,000 barrels of crude oil and naphtha annually, even though this volume of business seems indicated for the near future.

The Prairie Provinces of Canada are able to consume the products of approximately 17,000 barrels of

[illegible]

crude oil daily, of which all but negligible amounts were imported, principally from the United States, prior to the discovery of oil in Turner Valley in 1936. The advent of Turner Valley crude caused crude imports from the United States to practically cease within two years. By the same token, if oil is discovered in Alberta in any of the several tests which are now under way, the available market in the Prairie Provinces will have to be divided between Turner Valley and the production from such new discoveries.

It is not now economically feasible to transport Alberta crude to the Pacific Coast or to the Great Lakes, nor is there any need for Alberta crude in the United States where a condition of over-production of crude currently exists. It follows, therefore, that any large discoveries of crude oil in any of the Prairie Provinces will have an adverse effect on the earnings of the Division for the reason that its costs are largely fixed in dollars and are thus to a great extent independent of the amount of oil handled.

To cite a concrete case of a parallel nature, the Engineers in 1934 constructed a pipe line and crude oil pumping station for a client in the state of Montana, which facilities were used in transporting Montana crude oil into southern Alberta. In addition to the work done by the Engineers, the client himself constructed a gathering system of substantial size together with at least one oil storage tank of 80,000 barrels capacity. Within three years after these facilities were put into operation crude oil was discovered in Turner Valley and importation of Montana crude into Alberta stopped. These facilities are today idle.

During the year 1929 the Royalite Oil Company laid 15 miles of 6-inch trunk pipe line between Turner Valley and Calgary in a loop with, and paralleling, its then single 4-inch trunk line. This loop line was intended to provide for the transportation of the larger volumes of naphtha which the Company believed were to be produced in Turner Valley. The large volumes did not materialize and the loop line was never used for the purpose for which it was built, but was taken up in 1932 and the pipe used for other purposes, resulting in a loss to the Company represented by the costs of installing and reclaiming this 15 miles of 6-inch pipe.

While it is not intended to imply that risks of similar magnitude apply to the construction and operation of major trans-continental trunk lines, such as the systems extending from Oklahoma and Texas to the Atlantic Seaboard of the United States, it must be pointed out that recent discoveries of extensive crude oil reserves in the State of Illinois have seriously interfered with the traffic and earnings of several of these lines. The production from these new Illinois fields, discovered within the last two years, is located so much closer to many large refineries in the eastern States than the mid-continent crude formerly used, that not only is this crude, to the extent of nearly 100,000 barrels a day, replacing mid-continent crude which was formerly transported east by trunk pipe lines, but the trunk pipe lines have had to reduce their tariff from the mid-continent fields to the eastern refineries on such oil as they still transport from the mid-continent.

All of these experiences clearly indicate the necessity of a greater margin of possible profit in the

gathering and transportation of crude oil than would be considered proper today in the public utility business as that term is generally understood.

Pipe Line Earnings in the United States as Reported to the Interstate Commerce Commission for the years 1936 and 1937

In the United States pipe line companies are subject to the jurisdiction of the Interstate Commerce Commission if they are common carriers engaged in interstate transportation of oil by pipe line.

In 1936 there were 52 companies which reported to the Commission. The Commission's Bureau of Statistics has published Statement No. 3734 entitled 'Selected Financial and Operating Statistics from Annual Reports of Pipe Line Companies, Year ended December 31, 1936'.

While most of the pipe line companies reporting are larger than the operation under discussion here, there are three companies, the Arkansas Pipe Line Corporation, the International Pipe Line Company and the Toronto Pipe Line Company which are somewhat comparable in size and scope of operations. The Arkansas Pipe Line Corporation operates in Texas and Louisiana, International Pipe Line Company in Montana, and Toronto Pipe Line Company in Texas and Montana. These companies reported for the year 1936 as follows:

Name	Investment in Carrier Property	Operating Revenue	Operating Expenses	Pipe Line Operating Income
Arkansas Pipe Line Corp.	$1,205,273	$ 887,161	$ 250,853	$ 501,20
International Pipe Line Co.	462,929	354,196	137,548	167,02
Toronto Pipe Line Co.	724,636	543,695	234,447	246,95

Personally, I built two of those properties out of the three.

" The percentage of 'Investment in Carrier Property' represented by 'Pipe Line Operating Income' of the three Companies for 1936 is, by computation, as follows:

Arkansas Pipe Line Corp.	41.6%
International Pipe Line Co.	36.1
Toronto Pipe Line Co.	34.1

To the Engineers' knowledge these companies are all engaged in operations not dissimilar to that of the Division. The ratio of pipe line operating income to investment as shown by these companies for the year 1936 is, therefore, fairly comparable with that which will be shown by the Royalite's Pipe Line Division when operating at its present indicated annual rate at the present tariff of 15 cents per barrel.

For the year 1937 these companies reported as follows:

Name	Investment in Carrier Property	Operating Revenue	Operating Expenses	Pipe Line Operating Income
Arkansas Pipe Line Corporation	$1,246,890	$882,085	$238,187	$ 454,780
International Pipe Line Company	485,856	302,534	131,070	124,994
Toronto Pipe Line Company	690,325	363,805	187,189	135,083

Percentage of 'Investment in Carrier Property' represented by 'Pipe Line Operating Income' in calendar year 1937 - by computation are:

Arkansas Pipe Line Corporation	36.5%
International Pipe Line Company	25.7
Toronto Pipe Line Company (A)	19.6

Note: (A) This Company's operations in Montana were adversely affected by the discovery of the Turner Valley oil field in Alberta."

Q MR. COMMISSIONER LIPSETT: Are those all independent companies, Mr. Hill, or are they subsidiaries of other companies?

A I will tell you what they are. The Arkansas Pipe Line Corporation is a subsidiary of the Arkansas Natural Gas Company. It in turn is a subsidiary of the City Service Group. That is it is a City service company. The International Pipe Line Company is, I believe, owned substantially by the Texas Corporation. The Toronto Pipe Line Company is a subsidiary of the British American Oil Company.

Q That Toronto Pipe Line Company, does it transport oil for the British American?

A The Toronto Pipe Line Company operates a gathering system in the East Texas oil field, where it gathers oil from the wells of the British American and other companies, from whom the British American purchases, and delivers that oil into the main trunk line going to the Gulf, which is not owned by the British American. That is a gathering system like this out at Turner Valley, almost exactly, It also owns this property which I am very familiar with, because I built it, the property in Montana. That is a gathering system which takes crude from a considerable number of wells in the Cutbank Oil field and gathers it

at a station at Seeba, Montana, and delivers it 26 miles to the International Border at Sweet Grass. That is the property which was shut down by the Turner Valley oil field.

Q THE CHAIRMAN: What rate per barrel are these companies allowed for comparable distances?

A The Toronto Pipe Line Company, I know that rate, is 15¢ for gathering and transporting 26 miles. I will give you the tariff number.

MR. NOLAN: 36 and 37. We will send for that. These tariffs are all published.

Q Very good.

Q DR. BOATRIGHT: Is this what you want?

A I think they may be in there. The Arkansas Pipe Line Corporation Tariff I. C. C. No. 4, rate from Castor station, Texas, to Shreeveport, Lousiana, transportation charges 7½¢, gathering charge 5¢, a total of 12½¢ per barrel.

Q THE CHAIRMAN: And the distance?

A Approximately 50 miles.

Q 50 miles?

A Yes, sir.

Q MR. COMMISSIONER LIPSETT: How long has that line been in existence?

A That was built in 1931, sir.

Q 1931?

A Yes, sir.

Q Yes?

A The International Pipe Line Company Tariff I. C. C. No. 8, from wells within the territory of the International Pipe Line Company's gathering system in the Cutbank, Glacier County, Montana field, to Sweet Grass, Montana, International

Boundary. The Tariff is 16½¢, including both gathering and transportation. That system substantially parallels that of the Toronto Pipe Line Company, which is the other system that I have reference to here. It is not quite parallel, the wells are a little differently grouped, but it does the same service.

Q And you might, perhaps, have the distance?

A It is about 25 miles. That is correct, within a very short distance.

Q And to complete the information, when was that International line built?

A That line was built, I am going to make a guess at this one, I would say about 1930. It might have been prior to that. 1930 or 1929 possibly. The Toronto Pipe Line, I. C. C. Tariff No. 2. The origin is wells within the territory of the Toronto Pipe Line Company's gathering system in Cutbank, Glacier County Montana field. Destination Sweet Grass, Montana, International Boundary. Tariff includes gathering and transportation and is 15¢. That line is exactly 26 miles long.

(Page 2493 follows.)

Q Built about when?

A Built in 1934. Now my next paragraph, in fact you will be glad to hear the final one......

Q Perhaps you will give me a little further information before you pass to that. Do you know the quantities of through put of these particular lines?

A No, I do not. I can only guess at that from the size of the line. I do know what the Toronto through put was when I was running it. I ran it for about a month and at that time we were handling about 4,000 barrels, through a single 5 inch line. I am going to guess at the Arkansas, and I won't be very far off, because it is an 8 inch line. I am going to guess 20,000 barrels.

MR. FRAWLEY: As far as the Toronto pipe line is concerned, Mr. Harvie can get us the precise figures?

A I built that line and I happen to know it is 26 miles long.

Q But the through put?

A Yes, he can get that.

Q THE CHAIRMAN: Did you say 36?

A No, 26.

Q Have you any idea about the International?

A I cannot say about the International. I have no way of knowing. I would judge it would be around 3 or 4 thousand barrels. I may be able to get it.

MR. FRAWLEY: I think we might get that from the Texas Corporation. It is a wholly owned Texas subsidiary?

A Yes, I think it is.

MR. HArvie: Am I to understand that we will be asked to supply that information?

A It is published in the I.C.C..

MR. FRAWLEY: If you will ask Toronto to send us those statistics.

A You might get it from the I.C.C., book.

Q Another publication of the I.C.C. will show the through put?

A That is the one I quoted from when I gave those investment figures. That is where I think well I am sure, you will find it.

Q If you have that booklet by the way, that statement No. 36 and 37, that is what you mean?

A I do not have it but I am sure that the Royalite has it. I did not bring mine with me.

THE CHAIRMAN: Will you get us that Mr. Nolan?

MR. NOLAN: Yes, my Lord, if we have it I will bring it.

"Comparable Gathering and Short-haul
Transportation Tariffs in the United States.

Published tariffs for the gathering and short-haul transportation of crude oil in the United States under conditions fairly comparable with the Division's operations, show for the most part a gathering charge of 5 cents per barrel and a transportation charge of 10 cents per barrel, a total of 15 cents. In one or two cases the charges depart from these figures, the gathering charge in some cases being as high as 7.5 cents per barrel, but as an average the tariffs under comparable conditions of haul will be almost exactly

15 cents per barrel, which the Division charges for the combined services of gathering, transportation and storage."

Now in arriving at that conclusion, I checked perhaps a dozen Texas tariffs into Baytown, Texas, from the surrounding oil fields. These tariffs are published by the Humble Pipe Line Company. I also took into account the three tariffs which you asked me about, the Toronto, International and Arkansas.

Q THE CHAIRMAN: Before you proceed, you spoke of some pamphlet, by numbers, just what is that?

A A tariff.

Q Yes?

A A tariff is.......

Q A tariff got up for the year?

A No, a tariff - here is a tariff.

MR. NOLAN: We intended, through this witness, Mr. Chairman, to suggest to the Cokmission what might properly be contained in a tariff. That has been drawn by the officials of this Company, with the advice and assistance of Mr. Hill. It seemed to us, perhaps, as he was here and we were doing this sort of thing it might be ~~of some assistance to the~~ Commission to see what provisions are in tariffs of this kind. They consist, as a rule, of two things, rates and the regulations, and with Mr. Hill's assistance we intended to bring before the Commission some of the clauses which, in our opinion, should properly be included in such a tariff. It includes as I say, a rate and regulations. It is not just the rate that is charged. There are regulations pertaining

to the delivery of oil, which are common to all these tariffs, and in case that the Commission did not know what these regulations were, or no evidence was forthcoming as to what they were, we thought it might be of some assistance to bring it in this way, and we have done that. I propose with your permission to ask Mr. Hill about these clauses that are put into this suggested tariff, and its regulations?

A I was proposing to say to the Commission what you said, that a tariff comprises the rate - comprises first a description of the facilities. That is it sets out the origin point or points; the destination point or points; the route, with a description of the carrier facilities, through which the oil is transported.

Q I think what the Chairman really meant was, is there a book of United States' tariffs that might be produced here for the assistance of the Commission?

A We have that. That is that book.

Q There is that one dated May, 1937. It is known as the Interstate Commerce Commission Tariff.

Q MR. FRAWLEY: It is just the list of tariffs filed with the I.C.C.

A They are more or less of a digest of these tariffs. In some cases, I think, you will find a full tariff there, where it is a new one.

Q A digest of the pipe line rates of the crude petroleum oil on file with the Interstate Commerce Commission, published by The Natural Petroleum Association, Munsie Building, Washington, D.C.

Q MR. NOLAN: It does not follow that those

tariffs have received the approval of the Interstate Commerce Commission?

A They have been posted, and unless - I may be wrong here - but unless there was an exception taken to the tariff it is posted and becomes effective a certain date after it is posted, unless it is challenged. Then in that case the Commission hears the evidence on the basis of the tariff, assuming of course, that is a tariff over which the I.C.C., has jurisdiction.

Q So a volume of this kind might be of assistance, and I have one which I have sent for and which we will file with the Commission, with its permission.

Q MR. FRAWLEY: Without getting too scattered about. The Interstate Commerce Commission, I presume, could have no jurisdiction over that pipe line which the Texas Company owns, running from the Cutbank field to its refinery at Sunburst. The International Pipe Line Company?

A I would say not, unless the Texas Company chose to submit that tariff to the I.C.C.

Q And the same would apply to the Toronto pipe line, running from Cutbank to Sweet Grass?

A I would take it that tariff would be under the jurisdiction of the Tariff Commission of the State of Montana.

Q It does not follow at all that these tariffs which have been filed with the Interstate Commerce Commission and have been subscribed to by them after hearings such as this one?

A No, because in many cases they have not been protested.

Q Some of them are pipe line tariffs, if we might call

them that, which are not used excepting to transport the oil of the parent company.

A Yes, that will be so. For instance the Toronto. I am hot sure about the Toronto. I say "Yes", because I assume that is so. I believe the International carry its own oil. The Arkansas, I think, carried most of the oil going to the other refineries in Shrevesport. But there are undoubtedly many tariffs that carry only oil of the posting company or some purchasing affiliate of that company.

(Go to Page 2499.).

Q The three pipelines which I know of in Montana, the Toronto Pipeline Company, the International Pipeline Company and that small line which Imperial owns which runs from the Kevin-Sunburst field to Coutts?

A That is the Montana.

Q The Illinois Pipeline Company?

A The Illinois.

Q It is a small Imperial subsidiary, now those companies carry, as I understand it, only the oil of a given company?

A Now I cannot say. I would not want to say about that because I do not know what happens to that oil after it gets to the border except in the case of the Toronto.

MR. FRAWLEY: Now Mr. Nolan was saying something about filing a tariff and anything which Mr. Nolan wants to file, if the Board thinks it would be of use it may certainly be filed but I was wondering if I should not state my position now with respect to what I conceive to be the duty of the Commission in connection with its pipeline rate and it might save some time in filing a whole Schedule of regulations which my friend himself called them. I at least conceive it to be the duty of the Commission to find out first what an adequate and reasonable cost to the Royalite Oil Company of transporting oil through its pipeline is and I say then that that consists of three main things, the operating charges, the amortization charge, - certainly what Mr. Morrison submits, it will serve my purpose at the moment, and a fair return upon the money. Then I say that that automatically becomes the fair and equitable rate because when the rate of return is written into these other costs, then the costs become the rate. Then as I conceive it the duty of this

Commission ceases because after all the Commission is not the Public Utilities Board of Alberta. That Public Utilities Board is still there and still functioning. The Pipeline Act of this Province gives that Board the jurisdiction to fix pipeline rates and that has never been taken away from it. Presumably of course no application would be entertained at the moment while this Commission is functioning, although conceivably it might very well be, and so I say all this Commission has to do, and I am trying to press its duties into something reasonable, and still competely discharge the duties of the Commission, I say what this Commission has to do is to find the fair pipeline cost as of today and under these conditions, and turn that into the rate, by allowing a fair rate of return on the money, and that this Commission has no need to and should not in my submission projects itself into the future to ascertain what will happen to the business of this company during the next six, nine, twelve months or two or three years and if the rate which this Commission should fix, be say 15 cents or something less or something more, and within two or three weeks' or two or three months' time, due to intervening causes, if then becomes unfair or in any sense improper, this company, or the users of the line, can go to the Utilities Board and have another rate fixed.

Perhaps there is no use of me to make all that statement at the moment but I thought it might be useful for me to make it so that my friend and his witness may have that view before them and more important of course that the Commission should have my view about it. That is what I conceive to be the duty of the Commission so I do not know whether it is of any value to the Commission to know what

these Schedules are that usually go along with the posting of the pipeline rates.

MR. NOLAN: I am quite aware that this matter has not been taken away from the Utilities Commissions of this Province but I am also aware of that fact that there is the possibility that that can be done and I may find that there is a rate fixed for my Company, not perhaps by this Commission but by legislative action which, in that event, then to all practical intents and purposes becomes the rate here. Now I conceive this to be my duty not only to my client but my duty to this Commission to bring before it everything which may be of assistance and it seems to me that if we are to find eventually that the reported rate of this Commission becomes the rate for this Company, it is important for my purpose at least to have before the Commission that kind of thing which is attached to the rate which is being fixed for the pipeline company. To put it simply this may be my last opportunity of bringing such evidence to the regulatory body.

THE CHAIRMAN: Well Mr. Nolan I do not think that we would feel justified in excluding any evidence which you think may be material. What weight we attach to it or what we do about it is a matter for us in the future. We will receive it.

MR. NOLAN: Thanks.

WITNESS: This page 29, as I have already said, repeats the classification that I had already given, the summary which I had already given.

THE CHAIRMAN: Is it necessary, do you think, gentlemen, or desirable that these figures should all be

[illegible] with the

[illegible] think this

[illegible] but I am [illegible]

[illegible] is not fixed for

[illegible] by legi-

[illegible] to all practical

[illegible] Now I con-

[illegible] but in my

[illegible] it everything

[illegible] it seems to me that if we

[illegible] rate of this

[illegible] Company, it is im-

[illegible] before the Com-

[illegible] is attached to the rate

[illegible] company. We put it

[illegible] bringing such

[illegible] I do not think

[illegible] any evidence

[illegible] in the future.

[illegible] already given,

[illegible] Clark.

[illegible]

read by the witness?

MR. NOLAN: Well to avoid the necessity of it, if it can be avoided, we have made this report accessible to my friend and to his advisers.

THE CHAIRMAN: Of course I am assuming that out of your ten copies you have supplied Counsel with copies?

MR. NOLAN: We did the day before yesterday, so that consideration might be given to the values of Mr. Hill's of these particular items, and I am hoping that there is no difference of opinion. I am not suggesting that our basis is acceptable to my friend, Mr. Frawley, but that the actual valuations that have been come to will be acceptable, in which event there will be no necessity now or at any time to go into these matters item by item. After all it is merely the particularity, it is only the particulars of the report.

THE CHAIRMAN: I did not mean that anything therein contained should not be examined nor did I mean that there should not be critical corss-examination upon it. I was just wondering if it was of any advantage in having this witness read these out loud. The Commission of course will read it. Counsel and his advisers no doubt have read it and if they have not they should but if anyone wishes the witness to read all of these figures of course he must, but we need not put him to endless trouble unless it is desired.

MR. NOLAN: No. I think that is the proper course.

WITNESS: Pages 29 to 58 inclusive simply contain the detailed price inventory of all the items in the property.

THE CHAIRMAN: Yes I understand. That is satisfactory, Mr. Frawley to you?

MR. FRAWLEY: Yes, my Lord.

MR. HARVIE: I have not seen the report, my Lord.

MR. NOLAN: I am sorry you did not get your copy.

MR. HARVIE: I can borrow Mr. Nolan's.

THE CHAIRMAN: I think, gentlemen, hereafter it must be borne in mind that we have reached a stage at which Mr. Harvie representing the British American is an interested party and extra copies of everything should be provided for him.

MR. NOLAN: I have now furnished Mr. Harvie with a copy.

THE CHAIRMAN: All right, Mr. Nolan.

Q MAJOR LIPSETT: This page 29, Mr. Hill, is that a summary of the various accounts from page 30 to page 58?

A It is.

Q Just summarizing them?

A Just summarizing them. It includes everything except the statement of my allowance, you might say, for going values, which when added to the figures here makes a total of not less than $1,700,000.00.

Q You tell us that page 29 is an exact copy of page 12 which you have read?

A It is, that is the page which I was referring to a moment ago.

Q MR. NOLAN: And the succeeding pages, Mr. Hill, are simply a breaking down?

A They are an itemized list of the company's property by

description. kind and class, and prices as I have described.

Q Yes, in great detail?

A Yes.

Q Now, Mr. Hill, I observe in this report---

Q THE CHAIRMAN: Excuse me, I take it there is nothing, there is nothing to be found in pages 29 to 58 other than the details of that which the witness had previously read?

Q MR. NOLAN: Now, Mr. Hill, is it clear that the report which you have read to the Commission contains all the material and that pages 29 to the end of the report page 60, are the particulars of what is contained in the report itself which you have today read?

A That is correct.

Q There is no new material in these later pages to which the attention of the Commission should be drawn by you now?

A No, there is not.

THE CHAIRMAN: That is what I wanted.

MR. NOLAN: Now, Mr. Hill, I observe in this report that you used the expression---

THE CHAIRMAN: The witness has had quite a time of it and I think we will take a five minute's recess).

WITNESS: Thank you.

(A FIVE MINUTES RECESS WAS HERE TAKEN).

Q MR. NOLAN: Mr. Hill, I observe throughout your report that has just been marked as an exhibit in this case that you used the expression "by the Engineers" and "the Engineers " what does that mean?

A Well that is an editorial "we". As a matter of fact I did this job myself.

Q And the inspections which have been made and the valuations

which are contained in that report are your inspections and your valuations?

A Yes.

Q Made as a result of your own personal examination into the property?

A Yes.

Q Now, Mr. Hill, turning to the report just for a moment, particularly at page 6, I see you have there a heading "Age of Property" and you say that they are new or substantially so, to elaborate that just a little bit you are referring there to the percentage of new property as against the percentage of old, are you?

A Yes.

Q And I think you have mentioned in passing, to the Chairman, those figures---

A 60%. I made an analysis of my classification of property by accounts and found that roughly or very closely 60% of the valuations had been, the dollar value has been installed in the years 1937 and 1938. I would say that 75%, now this is not an exact check but I think it is very close, 75% would have been installed during the past five years and 25% of the dollars back as far as, over the years back as far as the year 1925.

Q And in a word what would you say as to the condition of those properties, their physical condition?

A They are in a very high state of maintenance and uniformly in very good physical condition.

Q Yes. Now when we come to the question of your land valuations which are to be found on page 9 of the Exhibit 96, where did you get the figures for valuing your land?

A I---

Q There are two kinds?

A I used my own judgment on the lots.

Q Yes.

A I discussed the price of the land, use of the land in the Turner Valley field, that is the surface rights, with the land man of the Royalite, I cannot remember his name.

Q The land man?

A The land man, yes.

Q Was his name Bird?

A Yes, and after talking with him I decided to use the figure of $35 an acre as a reasonable to-day's cost of that acreage in Turner Valley that the company uses. The company owns the surface rights. Mr. Bird told me as a matter of fact it is very difficult at the present time for his company to purchase any surface right in and around Turner Valley, that to-day where they needed surface rights they had to lease them at rentals which were uniformly high; I think he said that the rentals approximated $50 an acre and of course if you capitalize that sum you get an absurdly high value for the land. He said in fact a number of years ago they had bought similar land for $35 an acre which was the latest going price that he knew of so I used that figure as applicable to these 33 - 9/10ths acres of land.

Q Now when it comes to the question of the appraisal of the pumping stations, what had you to assist you there?

A I had the total and detailed cost of the stations fairly complete. My own estimate checked those very closely. I think that in the total of the three stations I would check the book cost within 5% with the exception of

station no. 2, where my estimated cost is some $16,000.00 higher than the book cost. I dug into the books to find out why and found that there were two large pumps at that station which were on the books at $1.00 each. Those pumps as I recollect cost currently some 14 or 15 thousand dollars so that accounted for that difference.

Q You mean the two?

A The two. So that accounted for that discrepancy, otherwise my estimate on the three stations checked in very closely with the company's reported book cost.

Q So that is an instance where there were two pumps carried on the books at $1.00 apiece?

A Yes.

Q To which you have given a value of some 15,000 dollars?

A $15,000, well I can tell you exactly, well yes, I can give it to you fairly closely here, I gave the two pumps a new value of $17,900.00 for the two of them, because that is what two pumps just like them had cost a few months before but that price includes equipment, gear guards and v-belt drives and what not, which were not included in the dollars so that I would say that I probably added 15 or 16 thousand dollars in my appraisal for the two dollar book value of those pumps.

Q Now the field gathering pumps, how did you arrive at your appraisal of those?

A I sent out price inquiries to the principal makers of those pumps in New York, their exports department and got their prices for such of those pumps as they could identify, most of them.

Q Yes.

A I got the export prices and added the duty, excise taxes

and made no charge for the first, on the basis that to-day the company could buy the pump on that basis, although they are quoted in Calgary at considerably higher than that.

Q Yes, so your appraisal would be higher than the books?

A I do not know, I would not know, because I did not check the book figures on those old pumps. The new pumps, amounting to about half the total, I used the company's recent invoices, they had just been acquired during the past two months and Mr. Coultis got me the invoice and I used those prices.

Q Now so far as the tanks are concerned, what have you to say about those, in addition to what is in the report itself?

A The price I have used for tanks includes the tank itself, the foundation for the tank, that is the clearing of the ground and the levelling off of the ground to receive the tank, the firewall around the tank, the foam system, the foam chutes inside the firewall, the swing suctions if there any and there are some on some of the tanks and the painting. I got the prices on the bare tanks through the company, from the Calgary representative of, as I recollect it, the Manitoba Bridge Company and to those bare tank prices I added what in my judgment was a fair figure to cover the items which I have just mentioned.

Q Do you know how your appraisal compares with the book costs?

A I think it is not far from book costs, there might be a little difference. One of the tanks that was bought by the company or acquired by the company from the former Regal Refining Company, that was a very large tank, the

most expensive tank the company has and I believe that tank was bought on almost a scrap basis, it was taken down at Calgary and moved to Turner Valley and it was there completely rebuilt and on that account I would expect my appraisal figure might be higher on that particular tank than the company's books. Otherwise I would not expect much difference in the totals.

Q Yes. Now as to the trunk pipelines themselves, what about line number 1, would your appraisal there be higher or lower than the Company's book cost?

A I would expect it to be slighly higher because that line was built in 1925 by a contractor who at the same time was building the 12 inch gas main of the Calgary Gas Company in from Turner Valley and he put that line, the 4 inch naphtha line in as it was then, in the same ditch as the Gas line. His contract price, I happen to know the contractor and know about the deal because I was up there then, the contract price was 17¢ a foot but he didn't have to dig any ditch or do any back filling. He just put the one line in with the other and threw it in with the other and then back-filled the ditch. Now my estimate assumes that line to be in a separate ditch, as it now is, that is a number of years ago the company lifted that line and completely rebuilt it, that is, it cleaned it, painted it, that is coated it and set it to one side out of its proximity to the gas lino, dug, you might say, a new ditch, it is on a shelf as a matter of fact in the old ditch and back-filled it so unless the company capitalized work which it did on that line over those years I would expect that my reproduction estimate

would be somewhat higher than the actual cost of the line in the first instance because of the fact that the contractor did not have to dig a ditch for that line or backfill it in 1925.

Q Now what about the number 2 line?

A Number 2 line, I would also expect my cost estimate to be higher than the company's book costs of the line for this reason that I understand in 1929 the company acquired that line in place from the Alberta Pipe Line Company, I believe it was in settlement of a debt to the parent company and took that line over at a figure which represented not much more than the salvage value of the pipe. The line was not suitable for the transportation of oil because it had been built with victaulic couplings, which are a rubber joint compression coupling.

(Continued on page 2511)

The Company took that line up out of the ditch, cut the ends off, took the couplings out and rebuilt the line as a welded line, cleaned it and reconditioned it properly and then relaid it. Now in the reproduction costs estimate it assumes that that line had been properly built in the first place and if any part of all of that reconditioning cost has been charged to the expenses in the past, it would follow that my estimated cost, estimated value of that No. 2 line would exceed the Company's book costs.

Q All right, and then No. 3 line, how will that compare with the book costs?

A The book cost of No. 3 line would exceed my estimate because that line was built in the winter time, at least in part, and in my estimates I have assumed that the construction would be done other than in the three or four severe winter months.

Q What would you say as to the field gathering lines generally, how would your appraisal compare with the book cost there?

A It should compare almost exactly.

Q And as to the other items which you have mentioned, specifically, what would you expect would be the comparison between your appraisal and the book costs?

A I would expect that if the book costs are complete there should be little, if any, difference.

Q Now, Mr. Hill, in this report there is nothing contained in your appraisal as to the utilities?

A No sir.

Q Now what do we mean by utilities?

A We mean the services of electric energy and water,

furnishing of sanitation, as sewerage, septic tanks, and what not, the furnishing of warehouse space and storage and machine shop facilities. Those services are all provided to this Division by the parent, that is the Royalite Company, from its existing facilities at Turner Valley, which are not owned, and no part of it has been transferred to the books of the Pipe Line Division.

Q And generally used with the others?

A The service of these utilities is furnished, is jointly used by all divisions of the Royalite Oil Company, but they are not owned by the Pipe Line Division and secondly my appraisal covered only properties that were pointed out to me as being owned by the Division. I made no inclusion in my appraisal other than as a normal going value for the fact that the Company had the service of those utilities without making any of the investments which those utilities entailed.

Q In a word, your appraisal does not reflect the capital cost of those utilities?

A It does not.

Q But it does take them into consideration in the going value of this pipe line operation?

A It does.

Q Now if you are wrong about including it as part of the going value, then am I right in suggesting to you that they would have to be put back as part of the capital cost?

A There should be an allocation made, that is if this Commission or whatever regulatory body that fixes this rate base, does not see fit to allow any going value

for this Company on account of the fact that it does enjoy this service then it would seem to me that it must necessarily make an allocation of the capital cost of those utilities, and apportion some part of it to the Pipe Line Division for inclusion in the rate base.

Q Otherwise the Division would have to build its own utilities?

A Yes.

Q Have you any opinion to offer as to what that would involve in capital expenditure?

A Yes, it would, if the Division built its own utilities in my opinion, they would have to spend between seventy and eighty thousand dollars to provide a minimum, to provide a minimum of facilities necessary. That would exclude any investment in electric generating facilities on account of the fact that purchase-power is available now in Turner Valley but it would include water, warehouse, sanitation and the other elements of service which I have just described.

Q Is that all that you want to say about that?

A I think that is all.

Q Have you any knowledge, Mr. Hill, of the difference that exists in construction costs in the United States and in Canada?

A Yes.

Q Will you tell the Commission about that?

A At the present time in, that is say in the Mid-Continent Oil fields of the United States, the cost of pipe, fittings and valves, that make up the materials in the pipe line laid down, is about 60% of their cost in Canada; that is their cost in Alberta, laid down in

the Turner Valley field, the reason being that the freight charges from the United States' manufacturing centres to Alberta are extremely high, Canada imposes a tariff and there are additional certain excise and other taxes, all of which go to make up this substantial excess cost of materials over the United States' laid down price. For instance the cost of steel pipe in carload lots at Okotoks is approximately $118.00 a ton in the size which go to make up this system. Similar pipe can be laid down in most of the Unites States' oil fields at not over $70.00 a ton in carload lots, and very frequently for less. In buying oil company fittings there are very few Canadian manufacturers, although there are some, but your country's goods come in from the United States and carry not only the duties and various taxes, but the freight rates. Now in my estimate I did not, on fittings, I did not include any freight on the assumption that there would be sufficient fittings of the lower pressure classes bought in Canada at lower prices to offset the freight on the higher pressure fittings from the States, but generally speaking I think I can say that for materials there is a very substantial difference against Alberta in construction costs.

For labour there is in most areas of the United States, a common labour rate at the present time which is from 40 to 50 cents an hour, I think 45 cents an hour is a fair average. I consider that that is not materially different from the present common rate of wage in the Turner Valley field, so the labour is about

the same.

Materials are substantially higher.

Q Now to turn to anot r subject for a moment, Mr. Hill, it was said in evidence yesterday, by Dr. Boatright, that if a shallower field could be found that its discovery would not stop drilling in this deeper field in the Turner Valley, do you agree with that or do you not?

A Well it would not stop it, no, because companies whose fates were tied up with the deeper fields, they have their investment there, who have made heavy commitments for acreage and who have drilling obligations or whose refineries or other investments were close by, would continue to drill, but I think the discovery of shallower fields, generally speaking, will result in cheaper oil and make it less profitable to drill in the deep fields.

Q Would it be fair, then, to say that it would curtail drilling?

A That would be, I think a fair statement.

(The Hearing was here adjourned to be resumed at 10.30 A.M. January 20th, 1939).

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J. J. FRAWLEY

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The Province of Alberta

IN THE MATTER OF THE PUBLIC INQUIRIES ACT

—and—

IN THE MATTER OF a Commission, dated the 12th day of October, A.D. 1938, to inquire into matters connected with Petroleum and Petroleum Products

Commissioners:

The Honourable MR. JUSTICE McGILLIVRAY
(*Chairman*)

—and—

L. R. LIPSETT, ESQ.

Session:

CALGARY, Alberta JANUARY 20th, 1939

VOLUME 19

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EDGAR G. HILL, having been recalled, examined by Mr. Nolan said:

Q MR. NOLAN: Mr. Hill, I think you were present at the time that Dr. Boatright went into a discussion with Counsel and with the Commissioners on the question of profits which had been earned by the company in the past, and stated that in his opinion they should not be taken into consideration in fixing a rate for the future, you were here?

A I was here.

Q Do you or do you not agree with Dr. Boatright's views on that matter?

A I do.

Q Have you anything to add to it?

A No sir.

Q You are in complete agreement with him on that point?

A I am.

Q You heard his evidence?

A I did.

Q Then, Mr. Hill, we know that in May of last year you made a report which we call the "May report" which I think is Exhibit "97" and your other report is dated December and is Exhibit "96", would you just give me in a word the main differences there are in those two reports?

A There are differences in the appraisal due to two primary causes, first, the inventory of the property, considerable property was added between May and Dcember of this year, of last year rather.

Q Yes.

A The unit prices vary in some cases because prices of pipe declined between May and December and in my December report

I have taken into account that fact.

Q Yes.

A There were a few minor errors in inventorying and in pricing in the May report which I caught and corrected in the December report.

Q Yes.

A In the May report I made an inadequate allowance for the company's working capital.

Q You made an allowance of how much?

THE CHAIRMAN: An inadequate allowance?

A An inadequate allowance.

Q MR. NOLAN: How much did you put in?

A Less than $40,000, I cannot remember the exact figure.

MR. FRAWLEY: $35,000.

Q MR. NOLAN: $35,000, and what have you put in the December report?

A $80,000.

Q Do you know whether or not that is adequate or inadequate, that $80,000 figure?

A In my opinion it is adequate.

Q Yes.

A In the operating expenses estimate which I made in May I made no allocation of the company's general expenses or of their utility cost, that is the parent company. I omitted to do that and in the December report I have taken the allowance for expenses as computed by the company's auditors, Price, Waterhouse & Company.

Q At how much money?

A Well they, the Price, Waterhouse & Company computed the operating expenses of the first nine months of 1938 and I started with that figure in my December report and made

certain adjustements to it. In May I have no auditor's report of any kind to work from. I only had the first three months direct operating expenses as given me by the company without audit. I made some adjustments to that as I say, they were not entirely complete, and in May I made an estimate which is less than the estimate which I now make for the twelve months ended June 30th, 1939.

Q Just in the provision for the increased annual costs of construction and operation in the May report?

A I used $50,000 a year.

Q In the December report?

A $125,000 a year.

Q Why that variation?

A Now, in the light of the company's experience in the last half of 1938 and my $50,000 allowance is obviously inadequate; that is also particularly evident in the light of their budget for 1939 for capital expenditure, so that of necessity I made a correction to reflect the inadequacy of my May allowance.

Q Yes.

MR. NOLAN: It will be necessary, Mr. Chairman, for me to prove properly the budget for the year 1939 through a proper officer of the company but perhaps I might be permitted now to put in through Mr. Hill the figure given to him by the superintendent of the pipeline department for the year 1939.

MR. FRAWLEY: You will prove it?

MR. NOLAN: Yes.

Q MR. NOLAN: Do you know it, Mr. Hill?

A Well I have here a letter from Mr. Burns, the company's treasurer, giving me the details of the physical capital

budget for the year 1939.

Q Yes.

A The budget amounts to $263,500.00, of which $25,000,00 is a contingency allowance.

Q Do you agree that $25,000.00 should be put in that budget as a contingency?

A Well I think that in any budget that is made for a year's expenditures should properly include an allowance for unforeseen contingencies. It is quite common in budgetting but that is the amount which has been included in this budget for contingencies, leaving $238,500.00 for definite items which I set forth in detail here.

Q And which we will have to bring properly before the Commission as part of the evidence which it should have. Now Mr. Hill, you have used as a basis of your report Exhibit "96" what is called "replacement value" and that is on a theory other than the theory that has been expounded by Dr. Boatright and the auditors for the Commission which is, I understand it, is on the principle of books cost, what have you to say as to the relevant merits or demerits of those two theories, if they be theories, are they theories?

A Well they are not theories. They are recognized methods of ascertaining a rate base.

Q Then what have you to say as to the merits or demerits of those two methods?

A As far as the book costs are concerned, if the books costs are based on an accurate inventory of the property and the costs of the, the origianl construction costs or acquisition costs of machinery for instance and the construction costs of the plant, the original cost of construction of the plant and the actual acquisition costs of the machinery items when

[illegible]

[illegible]

originally acquired, if those are all set forth so as to give a true picture of book costs then there cannot be much difference between the sum total of all those book costs and any estimates, any estimates made by a competent person, of reprodcution costs at a date certain. The inventory will be the same. The costs, unless a substantial part of the properites were built as you might say pre-war, when costs were half what they are now, unless a substantial part of the property was built pre-war, there should be no substantial difference between a sound estimate of reproduction costs and the company's books as of the same date.

Q Yes.

A In many cases the company, the books of companies particularly of a division such as this, where its property account was coupled for years with the parent company, in many cases the company's books do not reflect those costs.

Q Why do they not?

A From improper bookkeeping, or the fact that certain items of property in the past might have been charged up to expenses, the property is there, belongs to the company but you cannot find any record of it on its books. Now just for those two reasons alone I think that any Commission or Court considering a rate basis should have before it as a guide a properly prepared estimate of reproduction costs which contains a complete inventory and description of the property which is involved.

Another reason is this that, I think that it has been pretty well established in the United States at least, that any Commission or Court fixing a rate base must have before it some competent evidence of the value of the property.

In my opinion the book costs may or may not reflect the properties valued, much depending on how the books were kept, whether all capitalization was all accounted for in the capital account or not.

Q I remember you saying that two pumps were taken in at a dollar?

A That is just one indication of what I mean; those pumps are $7,000.00 pumps, they exist and they are doing their work every day but if you hunt through the books for those pumps you find a dollar. Now obviously these pumps are worth far more than a dollar and there is an example of where book costs, unless it is very critically scrutinised, can lead one astray.

Q Will you say that, because this was a going concern it had anything to do with the propriety of reproduction costs as against book costs?

A Well reproduction costs and the book costs, either one of them would reflect the going concern value. The going concern value is something intangible, which attaches to the company because it is in operation, well staffed, efficiently operated and it has customers attached and it is earning money.

Q Yes.

A Now I think it is perfectly obvious that a business which is established and has customers attached and has earning power, whatever the earning power may be, is worth more than a collection of physical units ready to operate but not yet endued with life, you might say. Now that difference, intangible difference, is what we term the going value and I have tried to appraise it as a matter of my judgment. I think it exists and that the Courts or Commissions in attemping to fix the value of this property in a public ser-

vice must and should take into account the fact that it is a going business, earning money and not just a collection of pipe, fittings, valves and pumps.

Q And as a going concern, would it not have a value greater than the first cost of the value of its components parts?

A Well assuming that it is efficiently operated and has customers attached and has a current earning power I would say it would have very definitely.

Q Yes, then there is the question of whether or not the life may never be realised, does that enter into your taking the reproduction theory or method?

A The life of the field you mean?

Q Well I was thinking more of the life of the field as reflected in the life of the pipeline itself.

A Oh I think, no, I cannot answer that question, yes or no, except to say that I do not think it makes any difference. I think the physical property here will last as long as the field does.

Q Yes, and you said yesterday I think just at the adjournment, that the discovery of a shallow field would not preclude drilling in a deeper field but might curtail it?

A Yes, depending on the economics of the situation.

THE CHAIRMAN: Mr. Nolan, before you open another subject, this going value of which this last witness speaks, let us understand it, is that what is ordinarily called "good-will" or what?

Q MR. NOLAN: You say you have taken into consideration the going value of this property?

A Yes. Well I am not, I have not taken into account good-will because my understanding of good-will is totally different than going value.

Q Now that is just the point, first of all, what is going value

in your opinion?

A It is the difference between the value of a company, a commercial concern, in operation, efficiently staffed with its customers attached and earning money and the summation of the value of those component parts priced at book cost or reproduction cost or on whatever basis it may be used, it is that tangible difference in value attaching to a company from the value of its business rather than simply the value of its components parts of the brick and mortar or steel which makes it up.

Now "good-will" is something else altogether. The company might have good-will, all the good-will in the world, that is the attitude of the public towards it might be most favourable, yet it might have no going value whatever.

Q Yes.

A And it might be poorly managed, it might be losing money, you see, you have good-will and no going value. Conversely the company might have and often does have a very definite going value with little or no good- will. Good-will as I understand it is the attitude of the public towards the business, the public in general.

(Go to page 2524)

Q THE CHAIRMAN: Anything of value is something that should be capitalized in the making of the rate, as though money had been spent on a building for example. In the same category.

A I do. I think in the United States, I am certain the United States Supreme Court has definitely held that. I am not a lawyer and I am going to leave that to Counsel, But in my country I can say goodwill is a definite element of value.

Q We could see more advantage if you/selling a business, but what I am asking about is, do you put it on the capital side just as you would the other?

A Yes.

Q In determining what the rate should be?

A Yes sir. I think these Commissions should consider in fixing that rate whether or not this Company is worth more as a going concern than merely an aggregation of brick, mortar, steel and pipe, and what not.

Q MR. NOLAN: Do I understand that it is customary for pipe line companies in the United States to have a tariff of rates and regulations?

A Yes.

Q And these are published are they not?

A They are.

Q And you have given your advice to this Company as to what you think might properly be contained in the tariff, for transportation over the pipe line that we are now inquiring into?

A I have read the tariff as prepared by Mr. Coultis, and I made some suggestions. I proof read it,

Edgar F. Hill.

and I know what is in it.

Q And do you approve of it or do you not?

A I do approve of it.

Q MR. NOLAN: I do not know whether this is the way of putting this in or not. Mr. Hill has looked at it. Perhaps you will prefer that an officer of the Company should discuss it with the Commission, but if you feel.....

THE CHAIRMAN: What is that?

MR. NOLAN: This is a number of rules governing the rate which should be charged. Of course, this is not what is to be accepted by the Commission but this is an idea of what one finds in pipe line tariffs, the rates and rules that govern the rate for transportation. We thought it might be of interest to you to have some idea what is contained in tariffs of this kind. I thought at the outset it was only the rate that was paid. Evidently that is not it. There are rules. Perhaps it would save time if I might have this marked now. I will call any officer of the Company they ask. But if there is any point arises out of this, out of any of these paragraphs - it is not very long - perhaps Mr. Hill might have an opportunity to state his judgment on it while he is here.

THE CHAIRMAN: You have a number of documents you are offering. What are they?

MR.NOLAN: This document contains all of the rules and the rate for the pipe line division of the Royalite Oil Company, Limited, prepared by the Royalite Company, and simply submitted to the

[illegible]

Commission as such.

THE CHAIRMAN: That is Royalite?

MR. NOLAN: Royalite, did this. Do you object to that going in?

MR. FRAWLEY: No, no objection at all. It is a proposal. I see the first thing is that the rate of 15 cents. The Company is tendering that merely for the guidance of the Commission.

MR. NOLAN: And only that.

MR. FRAWLEY: Oh sure.

MR. NOLAN: It may be of some use to the Commission,

TARIFFS PREPARED BY THE ROYALITE OIL COMPANY LIMITED, PIPE LINE DIVISION, IS NOW MARKED EXHIBIT "98".

MR. NOLAN: There is an effective date on the top of it. It is made effective January 1st, 1939. It is entitled "Royalite Oil Company Limited, Pipe Line Division. Origin Stations; Tenderer's Tanks; Turner Valley Field, Turner Valley, Alberta; Destination Station; Terminal Tankage, Calgary, Alberta; Routes: Gathering Lines of the Royalite Oil Company Limited, Pipe Line Division; Turner Valley Tank Farm; thence Trunk Lines to Calgary terminal of Royalite Oil Company Limited, Pipe Line Division. Rates per barrel of 35 Imperial gallons at 60^{0} Fahrenheit, 15 cents." My learned friend does not want me to read it because it would take some time. He has read it.

MR. FRAWLEY: No, I have not read it. But you want to invite Mr. Hill's comments on some portion.

MR. NOLAN: Only if there is any comment

required on any portions of it. I may just put it in and leave it with you, Sir, and have it discussed by anybody else who may desire.

MR. FRAWLEY: Yes, I will have to ask the witness some questions on that.

THE CHAIRMAN: You will have to read it in any event.

MR. NOLAN: If there is any objection being taken to it I would be glad if my friend would make such objections now, so that Mr. Hill could make answer to any query that may arise. That may be a much shorter way of doing it.

MR. FRAWLEY: We will try to do that.

MR. NOLAN: That is all I have to ask.

Q MR. FRAWLEY: Mr. Hill, you made no allowance for any proportion of the utilities which you say served the Pipe Line Division, in your estimate that you made in May, and also in your estimate made in December?

A That is so.

Q But you did make an allowance, you made an increase in your depreciated value, depreciated estimated cost of reproduction of $185,756.00 or roughtly $186,000.00?

A Is that the difference between that figure and the $1,700,000.00?

Q That is the difference between $1,700,000.00 and $1,514,000.00?

A Yes.

MR. COMMISSIONER LIPSETT: What page are you at?

MR. FRAWLEY: If you look at Page 12, Sir, of his Report, you will find that the estimated cost of reproduction as of December 31st, 1939, is

the depreciated figure of $1,514,244.00.

MR. COMMISSIONER LIPSETT. 1938?

MR. FRAWLEY: 1938, yes. He has some discussion of that on Page 15. He says that $1,700,000.00 is the value as a going concern. So that he puts in the going concern value at $185,756.00 or roughly $186,000.00.

A That is not so. Going concern value and Working Capital. Working Capital is in that difference. Oh no, you are right. $186,000.00 is right.

Q THE CHAIRMAN: How much?

A $186,000.00.

Q MR. FRAWLEY: Now I want to call your attention to what I think is of some value. The utilities, I think it was agreed, I do not know how much, but I understand it is agreed or it is suggested that the total value of the utilities and service units of the Company are in round figures $1,000,000.00?

A I think that is correct.

Q And $186,000.00 would be 18.6% of the utilities. Do you agree that is a fair percentage?

A Well I did not make that computation, but it happens arithmetically that is so. I have attempted to make no allocation and I would not want to make a snap judgment. It happens it works out here that way. But that is not my calculation.

Q From what you know of that business would you think that is a fair portion to be allocated to the utility proportion?

A It is obvious I have not attempted to allocate any more, that I did not make any allocation whatever.

Q And that is all you would care to say about that?

A That is all I would care to say about that.

Q You increase the working capital between May and December from $35,000.00 to $80,000.00. Did you tell my friend why you had done that?

A In May I took as the materials and supplies of the Company only what they gave me as being on their books at that time. That covered practically only the repair parts and small tools. But obviously that was an error, as I soon determined when I realized that the Division used the general warehouse of the parent Company as its source of supplies. I made that correction which I think is a proper one, to reflect my ideas of what the normal amounts of materials and supplies a company of this type would carry on hand were it on its own, which I think would run between $40,000.00 and $50,000.00.

Q At Page 16 of your Report, your December Report, you make the statement that naphthas are not stored but are delivered direct to the refinery. As a matter of fact in actual practice, Mr. Hill, do you know of any different treatments which are accorded naphthas and crude oils?

A You mean generally?

Q Yes?

A They would have to be treated differently because of the difference in volatility. You cannot store naphtha the year round in open storage the way you can store crude. That is there is too great volatility. I think for practical reasons these napthas are run right into the refinery and blended immediately, after being

possibly treated, and used for blending agents immediately. They are not actually stored.

Q You mean to say that the Imperial Refinery at East Calgary has no storage of naphtha?

A I would not want to say that. I want to say that generally speaking, naphtha storage would be of a different type than crude storage.

Q I understand.

A Depending on the vapour pressures and the temperature and whatnot. As to what the refineries' storage storage facilities for naphtha are, I do not know.

Q I will read you two or three lines from Page 16 of December Report. "The Company's present tariff for the gathering of crude oil, crude naphtha and absorption naphtha from the run tanks at the well and from the absorption plants in the Turner Valley field and transporting it to and storing it in the ving tanks at the Imperial Refinery i Calgary, at 15 cents per barrel of 35 Imperial gallons. Naphthas are not stored but are delivered direct to the refinery. You were drawing distinctions there between what the actual fact is, as to how crude is handled and how naphthas were handled, and we wondered if that was quite the fact.

A I believe it is a statement of fact that naphthas are not stored but are delivered direct to the refinery.

Q Neither are crude oils stored, but they are all run into the refinery yard of the Imperial Oil Company?

A Well I am sorry, I have seen those storage tanks and I know there is oil stored in them?

Q By the Imperial Oil?

A No, by the Pipe Line Division, which runs these tanks as a practical matter and is stored in these tanks.

A Oh, I see, yes.

Q That brings up the question of the rental of the tanks. If a person went down there now, Mr. Hill, and walked into the Calgary Refinery yard, they would find Imperial Oil Company's oil stored in certain crude storage tanks?

A Yes.

Q And they probably would, unless it is used up immediately, also find some Imperial Oil Company's naphtha stored in their tanks?

A You probably would find that if there was any naphtha there, beyond immediate blending needs, it would be in storage.

Q And the crude oil, beyond the immediate refinery needs, would be stored?

A Stored in their yard.

Q By the Imperial Oil?

THE CHAIRMAN: Well.....

MR. FRAWLEY: I do not think I quarrel with the witness' view now about rental, but I was trying to learn the facts. It was on your advice that the Royalite Company began to rent storage from the Imperial Oil at the rate of $35,000.00 a year?

A No.

Q No?

A No. I had nothing to do with the matter of the Company's policy whatever.

Q Now let us clear it up. I am very anxious to be properly informed about that, Mr. Hill. I certainly want to have your view about this, and I want to know what the fact is. On the 22nd of June, 1938, Mr. G. H. Smith, Chairman of the Board of the Imperial Oil Company wrote to Mr. J. H. McLeod, certainly the President or General Manager in any event, stating - this is Exhibit "31" - "When Mr. Hill of the Ford, Bacon & Davis Incorporated arrived in Toronto he discussed with us the rental to be charged by the Imperial for the use of two 80,000 and one 40,000 barrel tanks at the Royalite Pipe Line terminal in Calgary. Mr. Hill agreed that $35,000.00 per annum was a fair charge and this has been agreed to by the Imperial Oil Limited; rental to be started May 1st, 1938. We are attaching copy of our Memorandum to Mr. George Stewart, which is self-explanatory. Yours very truly. G. H. Smith." Then follows a Memorandum to Mr. G. L. Stewart, Mr. Stewart being?

MR. NOLAN: General Manager of the Refineries.

MR. FRAWLEY: General Manager of Refineries in Toronto?

MR. NOLAN: Yes.

MR. FRAWLEY: This is a Memorandum, not signed but dictated apparently by Mr. F. B. Bimmel, he being......

MR. NOLAN: A Director of Imperial

Oil limited. That is wrong. He is not a director, he is the Pipe Line expert in the employ of the Imperial Oil Limited.

MR. FRAWLEY: From Mr. Bimmel to Mr. G. L. Stewart, dated the 20th of June 1938, two days before that. "With regard to the rental that is to be charged the Royalite Oil Company, Pipe Line Department, for the use of two 80,000 and one 40,000 barrel tanks, located at Calgary in the refinery yard, Mr. Hill, of Ford, Bacon & Davis Company, who made the appraisal of the Royalite Pipe Line, agreed to a top rental of $35,000.00 per year, which Royalite should pay the Imperial for the use of these tanks. This amount, Mr. Hill states, is the highest rental he can give these tanks, and this would be on the basis of installing new tankage of the same capacity. We are aggreeable to starting this rental charge as of May 1st, as our 6 inch line went into operation on May 5th. As to the charge to be made by Imperial for tank car loading, Royalite will pay Imperial 5 cents per barrel for oil tendered in Turner Valley by producers consigned for tank car loading, this charge to apply when Royalite bills a customer direct for this service, i. e., 15 cents for transportation and 5 cents for handling and loading at Calgary."

A Those letters correctly state the facts. But as far as policy is concerned, I had nothing to do with fixing that. As to whether or not the Tariffwwould include storage, I had nothing to do about that. That is the Imperial Oil Company

Q As to whether the tariff should include storage, you had nothing to do with it?

A Not at all.

Q Did you have anything at all, either directly or indirectly to do with the decision the Company made, apparently after you had been out here and made your appraisal, on the question of paying any rent at all?

A No.

Q Of any rent at all?

A No.

Q What part did you play in the transaction at all then, because apparently you discussed the rental to be charged. That was one way of describing it. Then in the next Memorandum you agreed to a top rental and so on. What part did you play at all, Mr. Hill, in the.....

A Just what that letter shows, that if there was to be a rental charged, and there was one proposed to be charged, I said I would not support anything over $35,000.00 a year.

Q You said there was proposed to be a rental charge?

A Yes.

Q When did you first learn of that proposal?

A In May 1938.

Q When you were out here making your appraisal?

A Yes, or possibly before I came out.

Q In Toronto?

A In Toronto.

Q You learned it either in Calgary or in Toronto?

A Yes.

Q And you are not clear whether you learned it before

you came out or after you got here?

A It was during the two weeks' period that I was on the work that I learned it. I cannot say exactly where it was. I was told by the officials of either the Imperial or the Royalite, or both, that these tanks were to be assigned to the Pipe Line Division and a rental charged for their use. That was told me as a matter of Company policy.

Q You just got it as a piece of fact from the Company, and you applied your mind to what the proper rentals should be?

A Just as those letters say.

THE CHAIRMAN: I do not think the witness goes that far. He would not subscribe to anything $35,000.00 but I do not think he saysthat he stated that was the proper rental.

MR. FRAWLEY: Perhaps we should have that.

THE CHAIRMAN: He made one answer to the effect..

Q You said you would not agree to anything over $35,000.00, but were you the one who fixed the $35,000.00?

A No.

Q MR. FRAWLEY: I will call your attention to what Mr. Bimmel says, in his Memorandum to Mr. Stewart on the 20th of June, 1938. First he says Mr. Hill agreed to a top of $35,000.00, and then "This amount, Mr. Hill states, is the highest rental he can give these tanks." Let us first make a fair inference from what Mr. Bimmel is saying. He is saying you were prescribing $35,000.00, which you say is the

highest rental you can give these tanks. I did not put a single thing into it that is not there.

A That is an absolute statement of fact.

THE CHAIRMAN: That does not say that, as I appreciate it. Beyond the $35,000.00 he would not have gone.

MR. FRAWLEY: Yes.

THE CHAIRMAN: It does not at all follow that if the witness had had the fixing of it he would not make it $10,000.00 or $20,000.00.

A They were not my tanks.

MR. FRAWLEY: The highest rental he would give?

A That simply means that I won't agree to anything more. I won't include in my estimate of the proper expense a rental of anything more than $35,000.00 but I will go up that high.

Q THE CHAIRMAN: That is your limit. You can go as low as you like.

Q MR. FRAWLEY: You did not prescribe the $35,000.00?

A No sir, I did not.

Q Perhaps this is a perfectly reasonable question, if they had come down to $25,000.00, would you have agreed to it?

A Yes.

Q If they had come down to $20,000.00, would you have agreed to it?

A I would say that anything - I would put that, in my view as the minimum. Anything in that range I would perfectly willing to see these rentals paid.

Q Fifty is the top for your purposes?

A Thirty-five is the top.

Q I mean thirty-five is the top, and about $20,000.00 you would say would be the bottom?

A Right.

Q Now, Mr. Hill, at page 19 of your December Report, and at Page 16 of your May Report, you discuss, commence a discussion of the probable cost of building and operating extensions to gathering systems. Now in your December Report you say that an allowance should be made of about $125,000.00, and why do you say that.

(Go to Page 2538).

A Because as new wells are drilled in the field, as I say there were 12 wells drilling when I wrote my report in December, as those new wells come in the gathering system is extended to them.

Q Yes?

A That is just as, the only gathering system there is in the Turner Valley field, and it has the job of gathering that oil and connecting up each well as it comes in as a producer, that involves considerable expense and the matter of pipelines, pumps,and operating labour, you cannot get away from it. The work, the company, as I understand it, this Division, is in the business of supplying a service out there in the field.

Q Yes; now, as I understand, I may be misinformed but I asked the question the other day, using the illustration of the 6 mile extension to the Home-Millarville well just recently, that, I was told, was a capital expenditure?

A Yes.

Q Well, now, if that is a capital expenditure, then the company only gets, dealing now with the extension to the Home-Millarville, all that appears in the company's current revenue and expenditure statement is 10%, so it was $10,000.00 off, if that little line cost $10,000.00, I have no idea what it will cost, all that we will find in the current items is an item of $1,000.00?

A Where does that come from?

Q 10% depreciation, amortized?

A I do not know what rate the company takes.

Q No, assuming they are using 10%?

A You will find two entries, you will find a capital entry of $10,000.00, plant account field gathering line......

Q Yes?

A Then in the operating expenses or deduction from income for depreciation you will find at the end of any period an entry for depreciation on that piece of property depending on the rate which the company were using at the time for that particular class of property.

Q Yes?

A Whether 10% or 5% or what not, you find two entries, one capital entry and one expense entry.

Q Quite so, but what would the company suffer by way of expenditure for that year, only the latter entry?

A Well, it would suffer $10,000.00 right out of the till, so far as I can see.

Q That is what I want to understand, you say that $10.000.00 would come right out of the company's treasury to pay for that line to the Home-Millarville well?

A Yes.

Q All right, now somebody else will have to, somebody else than myself will have to pursue that with you, Mr. Hill?

A That is fairly obvious.

Q Yes. Now, then, let me discuss, nevertheless, the allowance which you say must be made of $125,000.00 to take care of capital expenditures.....

A The capital and increased operating costs.

Q Yes. Now, I am making the suggestion to you and you deal with it as you think you should, that the only charge, assuming now $125,000.00 is the correct figure, that the only charge on a straight line depreciation basis would only be $12,500.00 and not $125,000.00?

A Oh, that is perfectly true, that is, if you handle that end according to strict accounting practices, let us assume this $125,000.00, $110,000.00 were capital and $15,000.00

were increased operating costs, and that is not a very bad rate, I am willing to stand on that.

Q That happens to be the very figures I have, because I want to discuss with you now the way you treat this $125,000.00, and I agree with you if $110,000.00 were capital expenditure and the rest were increased costs, now, I want to know, our minds are meeting now, Mr. Hill, what would be the only charge, on the basis that this company presently operates its books and accounts?

A I do not know how this company operates its books, precisely, so far as depreciation is concerned, but what would happen would be that the capital accounts of the company......

Q Yes?

A Would be increased by $110,000.00, that is the capital, added on the asset side of the balance sheet.

Q Yes?

A Now, in the operating expenses we would find $15,000.00.

Q Yes?

A Added, included in the operating expenses for operating lines and pumps, or whatever expense account the company may charge that expense to. Then, under deductions from income in the depreciation column we would find X% on $100,000.00.

Q $110,000.00?

A $110,000.00, depending upon what the company's depreciation policy was, and that completes the transaction for that year.

Q Then on that supposition, all the money you would need to handle that $125,000.00 you speak of, is $26,000.00?

A Well, I have to put up $125,000.00 from somewhere. Now, if you will give me ninety-eight and a half, I will go to work, but, otherwise, I have to find that money.

Q Of course, I want to know whether or not, what I am talking

about, Mr. Hill, I am only discussing now the treatment of the $125,000.00?

A All right.

Q You see, you put it all into operating expenses, I am challenging that treatment which you have given it?

A I do not deny the propriety of your challenge, I say that accounting practices might handle it otherwise, but if you sit down and follow up the figures and get all through you will find it does not make any difference; just as a matter of convenience, that is all, and if Mr. Morrison carries it through on any given basis I bet you will find that when you are all wound up and the last dollar is wound up the difference is very slight.

Q You have taken for ten years, I think, you want $125,000.00?

A And we will spend it each year, and I want it back that year. Then so far as my rates are concerned, I have a simple, easily understood basis. Now, we could make it more complicated but we will not make any difference in the final wind-up.

Q All right. Now, you say that it should be $125,000.00?

A At least that, I say, and I am putting that in purely as an educative guess.

Q Now, in May you thought that the same figure should be $50,000.00?

A Yes.

Q And you made the same comment precisely at pages 16 and 17 of your May report, using the same language, I think, precisely, as you use at pages 19 and 20 of your December report, except you change the figure to $125,000.00. Now, what was it, I think you said something to Mr. Nolan about it?

A Yes.

[illegible]

Q What was it that warranted more than doubling the May figure?

A Because I was obviously in error in my May figure. The company spent more than $50,000.00 in the last half of 1938, and in 1939 it plans to spend much more than that. I was wrong and I had to correct it.

Q Then one thing we can take out of the estimates of the company is that they expect that there will be, and this is just to carry the costs of drilling operations, the extensions of the gathering system, the company expects that there will be considerable drilling activity in the next year or so in the unproven part, or the proven part, of the Turner Valley field?

A Oh, there are 12 wells being drilled now and there will be more.

Q I just want to have your view about that, you then regard it as being a very, very probable and likely thing that there will be considerable drilling in the next couple of years in the Turner Valley field?

A I certainly do.

Q MAJOR LIPSETT: Mr. Frawley, before you pass from that we might get it clear; on page 19, Mr. Hill, you refer to this sum of $125,000.00?

A Yes.

Q As a reasonable estimate of the additional cost for construction and operation?

A Yes.

Q That is on page 19?

A Yes.

Q Do I understand you divide that now as to $110,000.00 for capital and $15,000.00 for operating expenses?

A That is reasonable.

Q So you can take that.....

A You might use that, yes.

Q Now, then, on the next page, page 20, at the top of the page, you treat that entire $105,000.00 estimated additional outlay as an expense item?

A That is simply oil-country bookkeeping, and if you carry it through, if we sit down and carry it through, realizing that we are not charging that we are not collecting any return on that money at any time, simply recovered as an expense, you will find that the effect on any rate or tariff is negligible. That is old-fashioned, oil-country accounting. Of course, it makes an accountant shudder, I will grant you, but as a practical matter it does not make much difference.

Q MR. FRAWLEY: All it does, it confuses me?

A It is fairly simple.

Q MAJOR LIPSETT: To continue, Mr. Hill; $110,000.00 of that $125,000.00 then appears in your books as a capital outlay?

A Yes, and it should.

Q It will appear?

A It will appear.

Q And on the basis of writing that off as depreciation we should allow some $11,000.00 per year?

A No.

Q On a 10% basis?

A That is true of the next year's, but we take ten years as the total future life of our investment here; for the first year's expenditures, that is 1939 expenditures, that would be depreciated, we will say, over nine or ten years, whatever

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the figure is you are using; the next $110,000.00 is depreciated over one year less, so we keep using a similar divisor for each increment of $110.00.00 until we get to the last year, when we repay that $110,000.00 in one year, theoretically, so our divisor decreases by one in each year, and if you work it out by mathematics it does not make much difference, whether you follow the strict accounting practice or use the crude method, which I did, because, after all, I was just trying to check up on the reasonableness of this rate, and not fix a rate, and I was using a crude oil-country man's method of figuring, but, as a matter of fact, it doesn't make much difference in the final answer, but I would not suggest to the Commission that the accountant to the Commission use that method in fixing a rate with accuracy because it is not accurate from an accounting standpoint, but from a practical standpoint it is.

Q That is what I am coming at, both the accounting and the practical, Mr. Hill?

A Yes.

Q Way, to fix a rate, according to your suggestion is to give you $110,000.00 a year for capital outlay?

A Capital outlay.

Q Yes, incurred in that year?

A Yes.

Q So that assuming your capital outlay is $110.000.00, we are going to give you out of the rate that whole money back that year?

A Yes, each year, that is a simple way to do it, as an expense, but you do not have to give us any return on that.

Q That is what I am coming at.

A That is the point.

Q That is what I am coming at, then for the next ten years, we are to allow you 10% of that capital outlay?

A As depreciation.

Q As depreciation?

A Yes, to recover it entirely.

Q So that on your figure we give you $110,000.00 the first year back again out of this revenue?

A Yes.

Q We give you then for ten years approximately $11,000.00 a year, it will be a little less?

A Just whatever it is to make up the $ 110,000.00.

Q Another $110,000.00?

A Yes.

Q And in the meantime we give you a rate of return which you suggest should be 13%?

A Not on that money, no, I do not want any return on that.

Q But we will be if we take it out of profit?

A In my method here I have forgone any return on that $110,000.00 at any time. I am treating it as an expense, getting it back in the year that I incurred it, just as though it were paid out for labour.

Q Although it is capital?

A Although it is capital and I am not asking for any return on it.

Q Then having got the money back in your pocket, or the company's pocket?

A Yes.

Q The first year?

A Yes.

Q You say we should set this up as a capital expense?

A No, I am not, I am not asking you to capitalize it again. I am simply treating it as an expense item and forgetting it. That is the rate basis will set up the one million-seven forever. In my way of figuring it there is nothing added to it. Any additions are treated as expenses recoverable when incurred and that is an old oil-country practice.

Q Are you correct in that because in this rate that you are estimating on page 21, giving a 13% on the million seven-hundred thousand?

A Yes.

Q You are asking us in addition to that 13%, to give you $110,000.00 a year?

A Because I am spending that much.

Q For additional capital?

A I am spending that much a year.

Q And then on top of all that you are asking us to give you approximately $11,000.00 a year for ten years?

A No I am not. I have not added anything to my million-seven, my million-seven now.

Q I am not talking about the million-seven, I am talking about revenue?

A All I am asking for is this, I have the million-seven now in my opinion I ask for a return on that, whatever it may be, the million-seven or whatever you pick.

Q 13%?

A I say that is what the company will earn and I say that is reasonable. Now whatever percent you take, you may choose to take, all I am asking is that you give me that percent

on a million-seven from now on out, plus what I spend there every year additional capital and additional operating expense, so we never earn in any year more than blank percent on one-million-seven but I will get my money back each year that I spend each year.

Q Yes, but on top of that at the end of ten years you will have a capital value of a million-seven plus 10 times $110,000.00, which would be there?

A Well I am not sure in ten years, I have a salvage value ---

Q Assuming a life say of 20 years or 30 years?

A Carrying on the same theories and you have the same answer, I am perfectly sound.

Q You do not agree you are charging this money out of revenue, your whole capital, the first year and that you are getting paid for it?

A I do not say, sir, if you follow that, follow up my argument there, all I am ever going to earn or ever be able to pay to my stockholders is the same percent of $1,700,000.00, and that is all. That is all I want, so that if I have made any errors you can correct me but I am sure I have not.

Q That may be all you are paying out but you are in effect adding $110,000.00 to your capital structure?

A Yes, but I am not capitalizing it. Now the accountants can handle it properly, from the accounting standpoint, and they will come out to the same answer, so I do not care.

Q Just to pursue that a little further, Mr. Hill, if I might, is it under the practice, as far as you know, been the practice of the company to write up their capital outlay in the past practically every year?

A Oh, no, they have handled it from the accounting standpoint properly, I understand they have, they have a balance sheet

with capital assets set forth and added to that every year and depreciated it.

Q Apparently for the purposes of fixing that, you gave an illustration of pumps which you say were worth $14,000.00, which have been written down out of income to a couple of dollars?

A I understood those pumps were not used in the pipeline division at all, they were over in the gasoline plant and they were transferred over to the Royalite's pipeline division at a dollar apiece.

Q You are setting them up now in your structure?

A At what they are worth. They use them every day. They are functioning every day.

Q And they either have paid for themselves or they take them on their books at $2.00?

A What they did I cannot say but there they are.

Q MR. FRAWLEY: Now I am going to leave that to be dealt with by someone else and I want to call your attention to one more thing, I am going to discuss with the witness, page 22 of his December report and if you would be good enough to look at that page, now at the bottom of page 21, Mr. Hill you have, you arrive at, the division's calculation that year, net income, $226,445.00 and it is 13.3% here, on page 21 of your December report, what we would call your rate base of $1,700,000.00?

A That is right.

Q And then on page 22 follows your comment that the return must be commensurate with the risk?

A Yes.

Q And on page 18 of the May report, which the Commission has not got yet but which I will now call to your attention, on

page 18 of the May report, which corresponds to page 21 of the December report, because there it is that Mr. Hill has the same figures which come to $226,445.00, at the bottom of page 21 or 13.3% of his rate base, at the bottom of page 18 in the May report his net income comes out at $321,188.00 or 22.2% of his rate base, which in the May report was $1,450,000.00. Now until you get copies of those, which the reporters will undoubtedly provide for us, you will have to be good enough to make a note, that Mr. Hill's rate base in the May report was $1,450,000.00, that corresponds to his present figure in the December report of $1,700,000.00 and he has explained to Mr. Nolan how that was increased, that is at page 18 of Exhibit "97", the May report, and the net income is, in the May report the net income is worked out at $321,188.00, equivalent to a return of 22.2%. Now you will turn the page, Mr. Chairman, your page 22 of Exhibit "96" and I want to read, I am now reading the May report and you can follow it in the December report.

"Return commensurate with risk."

The December report says:

"Return must be commensurate with risk."

And then I am reading from the May report:

"On the face of the figure so far discussed this estimated return of 22.2% on the minimum value of the property and business might appear excessive. In the opinion of the engineers, however, it is warranted and justified by the risks inherent in the business.

In the United States, tariff rates on pipeline systems serving isolated fields are commonly calculated---"

THE CHAIRMAN: What page are you reading from?

MR. FRAWLEY: I am reading from page 19 of the May report. Now your page 22.

THE CHAIRMAN: I see, I am following it now.

" In the United States, tariff rates on pipeline systems serving isolated fields are commonly calculated to return the investment in about three years. In the particular case under discussion it must be realized that there is no guarantee that the division will handle five million five hundred thousand barrels of crude oil and naphtha annually, even though this volume of business seems indicated for the near future.

The Prairie Provinces of Canada are able to consume' I need not read that paragraph, that practically is the same as in the other'.

The next paragraph:

" It is not economically feasible to transport Alberta crude to the Pacific Coast".

I need not read that because that paragraph is I think identical.

" To cite a concrete case of a parallel nature, the engineers in 1934 constructed a pipeline."

And I need not recite that because that is identical.

" For during the year 1929 the Royalite Oil Company laid 15 miles of 6 inch trunk pipeline between Turner Valley and Calgary in a loop".

And I need not cite that paragraph, because it is the same.

" These instances are cited as examples"

And then that departs, the December report is then a little different, is altered to some extent, but I will read the last paragraph in the May report, the one short paragraph:

[illegible] ing from [illegible]

[illegible] al [illegible] of

[illegible]

[illegible] I [illegible]

[illegible] tariff process [illegible]

[illegible] are [illegible] sections [illegible]

[illegible] might thus [illegible]

[illegible] it must [illegible]

[illegible] the divi- [illegible]

[illegible] thousand [illegible]

[illegible] even though [illegible]

[illegible] indicated for the [illegible]

[illegible]

[illegible] are able to con-

[illegible] not [illegible] paragraph, that practically

[illegible]

[illegible]

" [illegible] not [illegible] Alberta [illegible]

[illegible]

[illegible] paragraph is I think [illegible]

[illegible]

" [illegible] parallel nature, [illegible]

[illegible] in [illegible]."

and [illegible]

[illegible]

"These instances are cited as examples of the risks which are inherent in the business of constructing and operating oil pipeline systems serving individual fields. It is not intended to imply that similar risks apply to the construction and operation of major or trans-continental trunk lines, such as the systems extending from Oklahoma and Texas to the Atlantic Seaboard in the United States, but the two experiences cited above clearly indicate the necessity of a greater margin of possible profit in the case of a system of the type discussed herein than would be considered proper to-day in a more stable business."

Now, Mr. Hill, I am calling your attention, you probably know by now, I am calling your attention to this, that in May you reported to the company that, two or three pages of your report support your view that 22.2% on the minimum value of the property was a fair and reasonable one, having in mind the risks, and in December you, with the same language, tell the company that 13.3% is a fair return, having in mind the risks; now, have you anything to say about that?

A Just where did I say that?

Q Which one, the last one?

A Oh, yes, I see, I see it is. I see it is "warranted and justified", that is all. I see, on top of page 22.

Q Warranted and justified?

A Yes.

Q And exactly the same thing in December?

A Yes.

Q "In the opinion of the Engineers, however, this return is fully warranted and justified by the risks inherent in the oil business."

It is practically the same?

A Yes.

Q And in the May report you say "In the opinion of the Engineers, however, it is warranted and justified by the risks inherent in the business"?

A Yes, I am perfectly definitely of the opinion that a three year pay-off is warranted on these short lines and gathering system serving the isolated fields.

Q That means then that 13.3%, supposing that it were 22.2%, that 13.3% is not enough?

A No, I will not say it is not enough, I am saying that I am perfectly satisfied with the pay-out of three years on a gathering system and short lines serving isolated fields is customary in the business on account of the risks. Now, in this case if we take our 22.2% which we find in May and add our depreciation, it will just about get us the three year pay-off. That gives us, adding our depreciation, will give us probably, well, I don't know, five or six years' pay-off.

Q That is about double, but this Commission has to make up its mind about those things, these very vital things, and in May you say 22.2% and in December you say 13.3, now, that is more than double.....

A No, it is not more than double.

Q No, no, but it is a lot more?

A Well, I was talking about the rate, the 15¢ rate being reasonable or not, and I concluded in May it was reasonable and I concluded in December it was reasonable.

Q It is obvious, of course, what happened, your May figures worked out at 22.2% and you said it was right, and your December figures worked out at 13.3% and you said it was right?

A Correct, and in neither case did it come a shorter time

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than a three year pay-off.

Q MAJOR LIPSETT: Mr. Hill, assuming that one was satisfied that the rate should be fixed on your figure of $1,700,000.00, you say that to-day, taking that figure, the Commission should fix a rate which would give you 13.3% or 22.2%?

A I say if you fix a rate of 13.3% in my opinion you are warranted in doing so by the risk. If you fix the higher rate of 22.2 I also say that is all right. In fact, I do not, I am not in sympathy, this, perhaps, should be off the record, but I am not in sympathy with any attempt by any regulatory body to fix any rate to cover the transportation of crude oil, that should be off the record, but, as I say, I do not think it is a thing that can be fixed unless it is, you might say, "re-set" every year, basing your rate on conditions existing at the time.

Q That was not quite what I was putting to you?

A No, I know.

Q What I am putting to you is, supposing the Commission accepts your figure of $1,700,000.00, or some other figure?

A Some other figure.

Q When we have found that, should we fix a rate which will give a return of 22.2% or 13.3%, or any intervening figure, in your opinion?

A Why, I would say that, I am not going to suggest to you the rate which you fix, you know the rate which I have in my mind and I say a three year pay-out is customary in this business, that would mean a combined return and amortization of 33-1/3%, that is customary in the business. Now, I know that no regulatory body would ever fix such a figure, but, on the other hand, I say that the returns,

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the ordinary rates of return used in the electric and gas business do not apply to this business.

Q MR. FRAWLEY: Well, what happened....

A I have not tried to fix the rate here but I say the 15¢, in my opinion, is a reasonable rate.

Q MAJOR LIPSETT: If you were to get 22.2% on a mere $700,000.00, it is obvious that 15¢ is not enough?

A That is perfectly true. I say 15¢, in my opinion, is reasonable.

Q MR. FRAWLEY: But if you had gone, you see you made this report for the Royalite Oil Company?

A Yes.

Q In view of a pending application then before the Public Utilities Board?

A Yes.

Q And you made the December report for the use of the Royalite Oil Company before this Commission?

A Yes.

Q And it is a fair thing to say, I presume, if you had gone before the Utilities Board in, say July or August or September, whenever it was coming on, you would have said that 22.2% was a fair return?

A I would have said that 15¢ was a reasonable rate and that is all I have said here.

Q This would have been, I presume, filed with the Board, and they would have had your view that 22.2% is fair, because of the risk. Now, this is in the discard and you are....

A That is not in the discard. The Commission may have that, for all I know.

Q They have it?

A What I mean is, the Public Utilities Commission may have it,

for all I know. I am not trying to evade that in any way.

Q MAJOR LIPSETT: How can you say that 15¢ is a reasonable rate on both sets of figures, that is what I mean?

A It showed a higher return in May than it does in December, but, in my opinion, it is a fair rate, it is in line with current tariffs, it is a fair rate for the service rendered.

Q That rather suggests, doesn't it, if we fix it on a "horseback" figure, as we have had it described,.....

A Pretty much, yes, that is the way these things are actually done, there is, the minute you start fixing pipeline rates you are right in the oil business, you are estimating, balancing off one field against another, you are in the oil business, you are attempting to balance off the costs, you see, of Turner Valley crude delivered at Calgary or what not, or Moose Jaw or Regina, against some other crude delivered there, at that same point from some other source, and you are in quite an involved picture when you start this thing but again that should be off the record.

Q THE CHAIRMAN: Oh, no, we have nothing off the record?

A I mean that is not, you know that.

Q You say it is a matter, as I understand you, that it cannot be worked out with mathematical accuracy?

A But the rate-making body must use the best estimate they can of what is fair and just under the circumstances, that is my opinion. You know railway rates are now fixed in that same way.

[illegible]

Q MR. FRAWLEY: That means this, that this Commission has spent a lot of time, considerable time, in arriving - and admitted evidence in order to enable them to arrive at what the probable life of the Turner Valley field is - and there have been various estimates given - What you say is, that you advocate and submit and urge that this pipeline should be paid off on a three year basis. That means then if, say for the sake of argument the Commission took fifteen years as the life of the field, then after three years the 15¢ rate would go on, is that it?

A No.

Q What would happen?

A It would be reduced. I will tell you why it will have to be reduced. As any oil field gets older its production costs increase. It costs more to produce a barrel of oil, generally speaking, from old oil fields than from a new oil field. You have a barrel of oil transformed into gasoline and put into your tanks and is not worth anything more to you than it was when the field was new. It won't do any more work. It is exactly the same oil. But we have a higher production cost out here in the field. That oil will only be worth at Calgary just what it is to-day, in terms of energy. Its value, after all, is determined by competition. You have to get a price out in the field, which, after all, has some bearing on its cost, plus the carrying charge into Calgary, and we have to bring the all-over price in Calgary in line with what some other concern from some cheaper source can also put it laid down in Calgary. It is common sense then that it would be a wise thing while the Turner Valley production costs are comparatively low that the pipeline should get

its money quick so that when the increased cost of crude comes along in Turner Valley that pipeline rate can be cut so that the cut in the pipeline rate will serve to counter-balance the increased cost of production of oil, and so that the price of oil in Calgary will stay fairly flat. That is the theory back of this three year payout.

Q There is no value at all in this Board endeavouring to estimate how long these reserves will last?

A I felt it was highly interesting but purely academic.

Q How do you arrive at the three years?

A Fifty years' experience.

Q So it is just a horseback figure, as we have been saying. That is based on your experience in the past?

A The nearest example I can give to you is the Toronto pipeline in Montana.

Q THE CHAIRMAN: Have you figured out, assuming that the 15¢ a barrel were allowed, which you suggest, how soon there would be this payout, as you call it?

A That can be fairly readily computed.

Q Have you computed it?

A One would simply add the annual income there to the depreciation andthat means that no profit accrued in the meantime. You just get your money back. You start your earning then. But you have to take your income tax into consideration. The Income Tax Division does not recognize the payout. I have not made the computation.

Q You migh make it in the noon hour so we will have your own calculation and no one else's say-so. We have heard a lot from you about a payout. Let us hear how you arrive at a payout on your own figures.

Q DR. BOATRIGHT: Mr. Hill, with reference to this going concern value, that is inherent in any business, is

it not, which is operating and making a profit?

A It is inherent in any business that is operating and making a profit.

Q And it is a highly intangible thing, is it not?

A I do not think it is. It is impossible to make an exact evaluation, but I think it is quite tangible. I think that purchase and sale recognizes it very definitely.

Q Now, in building that going concern value, is it not true that the going concern value was developed as a result of the operating charges which had been made in the past?

A It has been the result of the expenditure of money and brains, skill.

Q And those brains in turn are represented by the operating costs from the time it was started?

A Yes.

Q Therefore, the going concern value was built up as a result of those operating charges, wasn't it?

A Yes. The going concern value came as a result of the operating costs.

Q Now, is it not also true that any equipment that is not put to use only has a salvage value?

A Not put to use?

Q Yes, a piece of equipment that is just standing somewhere and is not being used or is not being put to use, at the time that happens, that particular piece of equipment only has whatever its salvage value, or what you can get out of it at that time, is?

A It has a commercial value as a piece of property.

Q But when that machine is at work then it has a different value. It has a value in use, hasn't it?

A Yes, it has. Part of the going value attaches to that machine.

Q In other words, the point I am getting at is this, the going concern value surely represents the difference in the salvage value and the present value of that equipment?

A Oh, no, that is not so. Salvage value is something entirely different. I cannot agree there; because the junk value of this plant would be, perhaps, only five or ten per cent. of the physical cost, and I cannot conceive of a salvage or junk value as having any relation to a rate base.

Q No, but as a matter of fact, if we junk this plant, and it was not a going concern, all its value would be for salvage?

A Oh, no. You mean a plant new and ready to work? That plant is ready to go to work. It is a new plant.

Q But the difference between a going concern value and the value of the plant as at the present time, determined in any particular way, really represents the going concern value?

A You mean the difference between a salvage value and the new cost? Well, we are not talking about the same kind of going value. Because we could not....if we were to sell out this and liquidate it all we could get would be junk. If we were to sell it as a going concern we would get another price, which I think would exceed the component-costs of its various parts, and not the junk values on its various parts.

Q But, nevertheless, the going concern value is hidden in the difference between the so-called junk value and its present value for operating services with the plant, is it not?

A I think the going value is indicative of some of the cost of the component parts. I think if you were going to

[illegible]

buy a business, for instance, you would expect to pay more for that business than you would pay for the building and the stock of goods on the shelves.

Q Well, then, let us carry this out a little bit further. According to that line of reasoning this going concern value changes from time to time, does it not? As a matter of fact, in May, I believe, you gave a figure which amounted to $105,000.00, and then again in December you gave a figure of $186,000.00 as being the difference between your estimated value of the property and assigning that to a going concern value and not taking into account the utilities?

A Not taking into account the utilities. As a matter of fact, in December I did take into account the utilities. My figure of $1,514,000.00 does not take the utilities into account but my figure of $1,700,000.00 does.

Q In other words, your figure of $1,700,000.00 represents your idea of the physical value of that equipment in use at the present time, is that correct?

A No. It represents my idea of the value of the Division set up as it is a going concern and enjoying the use of those utilities.

Q And that figure of $1,700,000.00 includes a so-called going concern value, and your idea of the fair portion of the utilities which should be assigned to it, is that correct?

A Well, it includes that $186,000.00, which, in my opinion, is a fair representation of the company's going value plus and inclusive of the use of the utilities.

Q Now, you were talking about the various methods of valuation, I believe, and in doing so you brought out the

point that faulty bookkeeping, in using the method which I advocated, might lead to wrong conclusions. Was that more or less your idea?

A Well, bear in mind there I have no fault to find with the principle that you set forth the other day. It is completely and entirely sound and from an accounting standpoint they are infallible, and if they are consistently followed I have no quarrel with them whatsoever.

Q In other words, coming back to this $125,000.00 item, is this your opinion, that in the over-all picture of the pipeline's life, taken from the beginning until the end, until it is completely depreciated out, that figure of $125,000.00 will not make any difference in the over-all picture, or to any great extent, but you admit it will make a big difference in the yearly picture?

A Well, I had not looked at it that way. I ran through roughly, well, not too roughly, this set-up calculated on your basis, the basis you suggested, and the one I have set forth here. And when I get through at the end of ten years I cannot find 5% difference in the total amount of money taken out of the business in either method.

Q But the actual resultswill be highly different, will they not?

A They may be. Yes, I can see that, because in the early days of the operations, I am taking out more than I would be on your basis.

Q Let us refer then, and apply some of these things to your figures on page 21. Do you have your report there?

A Yes.

Q On page 21, at the bottom, that is in Exhibit "96", take the figure for annual gross revenue. You give that as $858,000.00. As you remember, or I believe I am correct in

saying that figure of $858,000.00 includes an anticipated revenue of 15¢ per barrel on five and a half million barrels, plus 33,000 barrels for pipeline losses?

A Yes.

Q Now, in the event then that six million barrels went through that line, and as a matter of fact, our figures show six million went through, then that figure would be increased approximately 10%, is that correct?

A Yes.

Q That then would give us a figure, an additional figure, of $85,800.00 to add to the figure of $858,000.00?

A It would add 500,000 barrels at 15¢, $75,000.00.

Q Then that figure would be a increased by an appreciable amount, would it not?

A It would by $75,000.00.

Q Now, go on to operating expenses and property taxes, $311,500.00. That included the last six months, I believe, of 1938, and a projected six months in 1939, did it not?

A Yes, it did.

(Go to page 2563)

Q Now you made adjustments for additional expenses due to capital investments which had been made during that period, in addition to the regular operating expenses which have occurred up to now?

A Yes.

Q And that brings out a point in connection with evaluations by the method which you were using, and that is this, that a present day valuation of a physical piece of property may or may not include values which had already been charged to operating expense, is that not correct?

A That is correct.

Q In the over-all picture you do not know on a present day evaluation whether or not these things were charged to operating expense, and in the event that the over-all picture is used, as I understood you were using it, then it means there is a great deal of danger of duplication which will occur, because on the present day evaluation you are including items which may have already been charged and are already reflected in the Operating Expense, is that not correct?

A That is true. On the other hand the Company had the option of either capitalizing these items or charging them to operation. They had had to pay for them just the same with their money out of their till. I cannot see how, in an unregulated company, what difference it makes how the company keeps its books. They got the property. It is theirs. There it is, ready to go on public service. I know this is argument, but I feel strongly that it makes no difference to a Commission, or should make no difference to a Commission

or Court about to settle a rate, how a Company has kept its books in the past.

Q Possibly I did not make myself clear. I think we are in perfect accord that past methods should play no part in a rate making case. You see I am pointing this policy out, that the method you were advocating towards this, in the over-all picture, operating costs which might have alre dy been charged into operations are reflected in the present day valuation?

A They might be or they might not be. I say that before we should set up our propety account, either on the basis you suggest or on the one I suggest, we should first take stock and see what we have. Now I think that on your basis of setting up a rate we will have to have a continuing property record. That this Company will have to prepare an inventory, usually in loose leaf form, showing each item of property that it owns, and which it has in public service, listing it by its description, the year it was acquired and its cost. Now that will be a page for every item of property, and if the books which the Company now has are complete to that extent and show each item of property the Company owns, what it cost and year it was acquired, I have no criticism. I would very seriously doubt whether it does include all those things, and I say that before any rate base can be set, particularly on book costs method, we have first to get our costs right and be sure we have got them all.

Q As a matter of fact the Company does have these records, doesn't it, in that form?

A I do not know. I know it has cost cards on a great

many items of equipment, but I would be very much surprised if this Company, or any other oil company, had a complete property record.

MR. FRAWLEY: If it is going to shorten the cross-examination, or assist Mr. Hill in arriving at his conclusions, I am sure that all these things that you say they should have, they have?

A I say if this $7,000.00 worth of pumps has a cost record of $1.00, it is not a complete property record.

Q DR. BOATRIGHT: There are records. This is the net value that is shown. But if these things are all taken into consideration would you admit that the method I advocate would be more nearly correct than your method?

A I say these methods are both correct, both proper and should supplement each other. I have no criticism of the method you suggest, providing it is consistently followed out.

Q Now, coming to this item of $125,000.00 you have previously discussed to a certain extent, in the event that only $15,000.00 of that amount had been charged to actual yearly expense, or operating expense, instead of appearing in your statement at Page 21 as an item of $125,000.00, it would appear as an item of $15,000.00, plus on your basis, 10% depreciation.

A A little less than $11,000.00.

Q A little less than $11,000.00. When you consider depreciation, you would add 10% return on your investment and you would also have had the depreciation, giving you a total of about $22,000.00?

A Whatever the present return was. It would have shown

less in the first year.

Q Then considering that item, which you have shown there and the other item, part of the Gross Revenue, that shows an amount there of around $175,000.00, that would have to be added to the $226,000.00 in showing the true rate of return for that particular year?

A Yes, that is if you take the $75,000.00 increase revenue for 1938 and the difference you got by handling my $125,000.00, according to strict accounting practice, you get a substantially higher return for that period than I show.

Q Also if we go down to the figure where you provide for amortization of capital, and in the event that were amortized on the basis of 20 years instead of 10, that figure in turn would have been cut in half would it not?

A Oh yes.

Q And that would have given a net result of over twice the figure that you show. In other words, the yearly return there, instead of 13.3 would have been some figure in excess of, twice 13.3?

A I have not carried that out. I know it would be substantially greater. Because if I am amortizing my capital on a twenty year basis rather than on a ten year basis, even if it is a sinking fund, it would be approximately half.

Q There is another inherent error in using the evaluation method, and that is that in the event the Company goes out and buys an asset, a capital asset, and in doing so makes a profit, that profit immediately becomes amortized, or immediately becomes part of the capital,

in your method of valuation does it not?

A Well I see what you mean. If you mean I am fortunate enough to buy a piece of property at 50 cents on the dollar and capitalize it, I immediately write it off in this valuation?

Q Yes.

A That is true.

Q For rate making purposes the Company would have got the advantage of a rate of return by the appreciation that was obtained by the purchase at the lower rate.

A True, and the converse holds, if we paid too much on a piece of property, under my basis I would write that down.

Q That is they are inherent errors?

A Yes. You can call them errors. They are inherent in the reproduction costs theory, yes.

Q On Page 26 there is a thing I would like to call your attention to, and ask you to explain. In the Statement beginning for the year 1937, the figures showing pipe line operating income for the Arkansas Pipe Line Corporation was $454.780.00. In that statement it shows operating revenue $882,085.00, and an operating expense of $238,187.00?

A Yes.

Q And it so happens that those figures do not check out?

A No, it won't, because taxes come in. That is after the taxes are paid. I think you will find I have.... I did not put that into a column.

Q No, I realize that. There is an obvious discrepancy there, and I was sure you could explain it. I just wanted to get the explanation. In other words, it is

your opinion that the difference of $882,085.00 and $238,147.00 is equal to $454,780.00 plus whatever taxes were taken out?

A Yes. All other deductions from income are shown I think. They are all there.

Q While we are on this analysis, is it not true that the amount of oil pumped through a line is much more important than the length of the line in determining a proper rate for that line?

A Yes. That is the traffic. The traffic, plus the rate, determine the gross, naturally.

Q But just from the standpoint of comparison alone, the amount of oil that is shipped through a line in a given year, is more important in determining what the rate should be than the length of a particular line, is that not true?

A Yes. I tried to show them both.

Q Do you show any volume figures in this report?

A Well they come out of the dollar. They can be added.

Q They are not shown in here?

A No.

Q As a matter of fact all these lines have much smaller volumes running through than this line. As a matter of fact they only have about one-fifth of the volume going through of this line. Didn't you say they were about 3000 barrel a day lines.

A No. The Arkansas, I guess that it, is a 20,000 barrel, because it is an eight-inch line. It feeds about a 25,000 barrel refinery. I think it is about a 20,000 barrel refinery. The International I do not know.

You may get it out of this book. The Toronto, as far as the Montana Division as I knew it is concerned, it was handling somewhere around 4000 barrels a day, and the Texas Division was handling, I do not know, but you can get it out of the book. They vary from year to year, of course.

Q I realize that, and that was the point I was trying to bring before the Commission. That is in any pipe line comparison you must have all the facts, and not just a portion of the facts, in order to draw a comparison between two different pipe lines. You see here you are drawing a comparison where all the figures are not there, and I wanted to bring out these things, that there are a number of other things, even though the lines are of the same length, which must be taken into consideration in attempting to compare pipe line rates. All of the information should be present, and not just parts of it. In other words, a partial statement loses its value because of the lack of other pertinent factors, is that not right

A That is true. But here we have, with respect to size, here for instance is the Arkansas Pipe Line with $1,205,000. We have then the gross operating revenue and its operating expense.

Q On what page?

A Page 25. That gives you some idea. I refer to the document where all that data is available. The through put I think is there,

THE CHAIRMAN: Where is this document?

MR. NOLAN: I have it now, Sir.

It is entitled "Interstate Commerce Commission, Bureau

[illegible]

of Statistics, Selected Financial and Operating Statistics from Annual Reports of Pipe Line Companies, year ended December 31st, 1936. Statement Number 3734, dated at Washington, D.C., December 1937." Is that the document you refer to Mr. Hill?

A That is the document.

MR. NOLAN: Might that be marked as Exhibit Number "99",

DOCUMENT IN QUESTION IS NOW MARKED AS EXHIBIT "99".

MR. NOLAN: This is not available in sufficient copies for everyone.

Q THE CHAIRMAN: What is the through put disclosed there ?

A I have not looked at that.

Q Tell us the through put of these three companies, the Arkansas, International and the Toronto?

A Arkansas 12,346,103 barrels.

Q DR. BOATRIGHT: Does that give the actual mileage? I believe you estimated these yesterday, but were not sure about them.

A 91 miles of gathering lines, and 86 miles of trunk line.

Q That would be a total of about 172 miles?

A 177 miles.

Q THE CHAIRMAN: International?

A International 66 miles of gathering lines, and 31 miles of trunk line. Through put 2,117,482 barrels.

Q DR. BOATRIGHT: That is per year?

A Per year. Toronto 109 miles of gathering lines and 26 miles of trunk lines. Through put 6, 354,229

barrels.

THE CHAIRMAN: That would be a definite place to stop, gentlemen.

(At this stage the Hearing was adjourned until 2 P.M.)

. . . .

MR. FRAWLEY: Mr. Chairman, Mr. Nolan and I have agreed that Mr. Taylor's report should be available, that is the Price, Waterhouse report, should be available to Mr. Morrison now because there is this particular reason for it. I ask Mr. Morrison from time to time to answer questions for me and to get information and he tells me that it may very well be that a lot of the things he is asked to do, for instance Major Lipsett asked him to do something yesterday, and it may very well be that the company has already done that and it is in Mr. Taylor's report, so I suggest we take one minute of Mr. Taylor's time, put him in the box, file his report and let him step down again.

MR. NOLAN: I have no objection to doing that, and we have in advance had multographed copies made of it and there will be enough for everyone. It will not be necessary to bring the multographed copies up now because we will only file the original report and there are sufficient copies to be distributed, if necessary, although they do not even need to be distributed yet.

MR. FRAWLEY: No. The Commissions' copies had better go in if it is filed, two or three or four or five.

JAMES WATT TAYLOR, having been first duly sworn, examined by Mr. Frawley said:

Q Mr. Taylor, you are the Toronto manager of the Price, Waterhouse Company.

A No sir, I am a partner of the Canadian firm of Price, Waterhouse and Company, resident in Toronto.

Q And under your supervision there has been made by your company a report, an investigation and a report into the

affairs of the Royalite Oil Company with a view to this Royal Commission?

A That is correct.

Q We will dispense with any further of your qualifications if you do not mind, until you come to give evidence, and will you please produce your report?

A The description of this report, "Royalite Oil Company, Limited, pipeline department, statement of operations for the period of seven years and nine months, ended September 30th, 1938; statement showing return of capital for that period and accompanying report".

(STATEMENT PRODUCED BY MR. TAYLOR HERE MARKED AS EXHIBIT "100").

EDGAR G. HILL, having been recalled, examined by Mr. Boatright said:

WITNESS: May I, Mr. Commissioner, I made a pay-out check calculation during the recess which you asked me for.

Q THE CHAIRMAN: Yes.

A I want to explain when I use the term "pay-out" I am not attempting to be slangy. It is a term used in the oil business quite generally, it is the annual earnings plus the annual depreciation charge, divided into the total capitalization and the resulting figure in years is termed the "pay-out".

Q Yes.

A Now in my December report my amortization charge was $131,186.00, and my return is $226,445.00, a total of $357,631.00, which divided into my capital of $1,700,000.00 results in a pay-out period of 4.7 years.

Q DR. BOATRIGHT: Now with reference to these pay-out figures, the pay-out figures for the pay-out time of 3 years

[illegible] of your [illegible]

[illegible] to give evidence [illegible]

[illegible]

pay-out check calculation during the process which you [illegible]

[illegible] to explain when I use the term "pay-out" [illegible]

[illegible] It is [illegible] in [illegible]

[illegible] it is the [illegible]

is what is customarily required by a bank, is that not correct, that is that is the pay-out period which is required for the investment of new capital in an enterprise, such as a bank, that is the generally accepted figure for pay-out so far as the attraction of capital is concerned in the United States?

A In the oil business.

Q Yes.

A I would say that is a fair statement.

Q In this particular case here, however, we have a highly different situation than a bank is ordinarily faced with in the United States, is that not correct?

A Well I do not know just exactly what you mean. That is the physical situation would be no different, it is standard, but it is different, if you mean the presence of a parent company or the resources of the parent company being back of the subsidiary?

THE CHAIRMAN: You might point to the differences you have in mind.

Q DR. BOATRIGHT: Yes. Here is one thing, in the first place that is an overall figure which is used in general for overall industries and has been built up by bankers as a result of their experience in that industry over the United States as a whole, is that not correct?

A If you say "bankers", I would say "by the furnishers of capital".

Q Yes.

A Yes, I would s y that is a true statement.

Q And the average field in the United States does not have as long an expected life as the Turner Valley field, does it?

A I do not know.

Q There is another thing; really is it fair to apply a banker's rule to an investment which is already made and which has been

in operation for 10 or 13 years?

A We are back again to the question of, I think a question of law largely, and I do not, I am not competent certainly to argue it.

Q Well the point I am making is this, that we are applying the rule of banking to an operation that is not that type of thing, are we not here?

A Well so far as the actual conditions are concerned, it is so similar to many similar situations that I cannot see where physically that it differs. The only conception of it, a different light that I can visualize is that this company is for better or for worse a parent, does not have to go to the, at least has not had to go into the money market for its funds. I can see that difference. I do not know whether it is a distinction or not.

Q Well to point out on the basis which you have used, you say that the pipeline company should operate to pay out in three years?

A Yes.

Q And as a matter of fact if we apply that to past operations that is exactly what has happened, is it not?

A Well I do not know, I imagine that some of the earlier investment has paid itself out, from past earnings. This property however has largely been built up in the last two years not under regulation. Then we get right back to that, we get right back to that matter of principle, which I think again is a matter of law.

Q Well the only thing I am trying to point out here is this, that if we apply this three year pay-out rule to the Turner Valley field, that certainly would not be fair in that respect would it?

A You mean to the Turner Valley, bearing in mind it has already

been in operation for two years?

Q Yes.

A No, you mean, if you are taking the three year pay-out rule and applying it to Turner Valley I would say that probably half of the three years has gone.

Q Yes, well applying that rule then on further, would you be in favour of saying that a year and a half has gone and we have a year and a half further to depreciate it out?

A No, I think I have set forth clearly in my report how I would propose to amortize this property at this time; I would amoritze it over ten years.

Q In other words then this property at least in that respect is not typically a three year property, in other words it is more or less of a ten year property in your estimation?

A And I have so regarded it.

Q Then the three year rule at least is not a hard and fast rule and must be modified by the circumstances which obtain in any particular given instance?

A That is right.

Q Now I had another point concerning a statement which you made earlier in the morning and I do not know that I can recall your exact words but I believe you made a statement which implied that the pipeline rate during the early life of the field should be much higher than the pipeline rate during the later stages of the pipeline's life, am I correct in that?

A I did not say it should be, I said it might well be, because of the fact as we all know production cost, the cost of producing a barrel of oil in the field tends to increase with the age of the field.

Q Well is it not true that during the early life of the field, and particularly with an integrated company such as this, that the drilling costs occur during the early life of the field and more or less offset the additional production costs during the latter part of the field, and from a capital standpoint at least involves about the same kind of expenditure throughout the life of the field, is that not the general history of oil companies?

A That is, that the general method of oil company accounting tends to level off book production costs.

Q Yes, in fact that is what happens?

A That is true but I think the experience in the States during the past few years, particularly with respect to the stripper property, has shown that there soon comes, there comeseventually a point below which the price of oil cannot go without resulting in an actual loss for every barrel of oil produced without reference to capital, just from the standpoint of operating costs.

Q Yes.

A I think we all know that with stripper oil at a dollar a barrel in the older field, that that dollar barely covers the actual operating costs of those wells and when we get to that point it is essential that there should be flexibility in pipeline charges to prevent that oil being marketed in competition with the oil from flush fields.

Q Well that brings up a point then that I believe it would be well to go into, from the pipeline standpoint alone, during the later stages of the field's life the operating charges are really higher per barrel of oil than it is during the flush run, there are more lines and more supervision necessary and all thoes various items which go into stripper production?

A The gathering cost will increase, I do not believe the transporation costs of this property will materially increase over the years, but the gathering cost will.

Q Therefore from a purely, from a pipeline standpoint at least the later stages of the field's life is just as bad as the earlier years?

A From an operating standpoint they are worse; if you have the capital,to provide for that burdens it still more.

Q But that faces it in two ways, or offsets it in two ways, during the early life we have a drilling cost and during the latter life we have the expenditures for production costs, don't we?

A We do but if we are going to keep Turner Valley oil, just using Turner Valley oil because it is the closest oil, competitive, it seems to me in the later years you have or should have considerable flexibility in our pipeline tariff generally speaking.

Q Well is it your idea that the pipeline must absorb the addition in price necessary to keep the field going?

A Not entirely but I think it would be a good thing if it could help. I know that is so in the States with respect to the Illinois competition, that the pipeline companies have had to reduce tariffs substantially in order to permit mid-continent oil to be marketed in the East and they have done it arbitrarily.

Q But in that particular instance, is it not possible for the pipeline to operate at a loss unless there are some other items such as refining to offset that loss, in other words that is only possible in an integrated company to do that, to meet that?

Q Let us assume, as I think it is so, that many of these pipelines have substantially amortized their capital, they do

not have therefore, any substantial capital charges to worry about. They are concerned more with operating costs and maintenance.

Q Then in the event they were able to do that, that simply means their pipeline rates were too high in the past and the Illinois simply made them come down to time?

A No, it doesn't mean they were too high, it meant they were sufficiently high in the good years to get their capital pretty well retired and then when hard times came they had no burdens from capital structure. I think the railways, the United States railways are as good an example of that situation as one could very well cite, I cannot think of any better. The railways have never, they never got their capital down low enough to let them meet competition when competition came.

Q Is it fair to compare a pipeline to a railway?

A The railways transport in two different directions and various materials and pipeline only transports in one direction, one material.

A I think the comparison is absolutely parallel. Oil does not go two ways in the pipeline, it could if it had to, but it usually runs in one direction but if the railways ran from only one direction it would not make any difference in the principle.

Q Is it your opinion that railways and pipelines are very similar or similar enough to draw comparisons between them?

A Well they both perform the same function, they transport things from one point to another for pay.

Q Would you recommend then that the rate which railways charge, the return on the investment which railways get, should be applied to pipelines?

A The railways do not make any money today, they are in the "red" generally speaking, that is the trouble with the way they

handled their affairs, they kept their capital structure top-heavy, never reduced it and assumed that conditions would be go on forever as they were during their early years and now they are reaping the consequences.

Q Coming to these tanks and this tank charge, did you make a valuation of those three tanks in the Imperial Refinery, did you look those tanks over?

A I looked them over.

Q And did you arrive at a fair figure?

A I did. I looked the tanks over last May.

Q Did you arrive at an approximate figure of their worth at that time?

A I did.

Q What was that figure?

A The two-80,000 barrel tanks are worth in my opinion about 60¢ a barrel.

Q The two-80,000?

A Yes, that is approximately 160,000 barrels worth at 60¢ a barrel.

Q That would make them worth about $96,000.00?

A About 96.

Q And the 40,000?

A The 40 is worth about 50¢ a barrel.

Q That would add another $20,000?

A And besides that there are certain pipe connections, appurtenances, firelines and what not, I would say those tanks as they stand today are worth, without the land, in the neighbourhood of $135,000.00.

Q Well I believe that you depreciated your equipment in your report on the basis of 10 years, that is 10% a year, is that correct?

A You mean that I have been using that in my setup, taking a 10 year life?

Q Yes.

A Yes I did.

Q And in that event then instead of the figure $20,000,00 which you gave Mr. Frawley this morning, you would have actually used a figure $13,500.00, being the reasonable amount?

A For the capital charges only. You see these tanks are operated and maintained by the refinery and those costs are included in the rentals.

Q Do you have any idea what those charges are with respect to those three tanks only?

A I was told that they were, that they ran about $18,000.00 a year but I do not believe that is so. I think it is less than that but there is a cost there which I cannot do more than get some, make some reasonable approximation for. You see you have, you asked me whether my 10 year depreciation allowance would go in that rental, it would, also the return on the tanks and their cost of maintenance, that is you have three items entering into this tank rental, the return, depreciation and operating costs and maintenance.

Q How long a life would you give those tanks, as long as they are kept up and the charges for keeping them up are applied to operating expenses?

A Oh, they will last almost indefinitely.

Q Certainly, they will last the length of the life of the pipeline?

A I would say so.

Q Whatever the life is for the pipeline?

A I would say, so, yes.

Q Just a point that I would like to bring out here, you remember that your figure for purchased equipment I believe was $1,619,00.00 approximately, that was new equipment, and new cost of the equipment which you included?

A The total valuation of the property new.

Q That is right?

A That is right.

Q And in our calculations which have been submitted by Mr. Morrison, our figure for that same equipment which we considered from a bookkeeping standpoint, which was the method which I have advocated, was $1,611,000.00, in other words those two figures indicate that we in our calculations from a bookkeeping standpoint used very close to the same equipment which you in your valuation used, is that not right?

A If those are the figures it is a closer check than I would have expected.

Q Yes, there was no argument about it, I just wanted to bring out the similarity between those two figures and the fact that we did in our calcuations use very close to the same equipment which you did. Now are you familiar, you are familiar with pipeline practices in the United States so far as oil pipelines are concerned, Mr. Hill?

A Generally. I have built many of them. My operating experience has been confined to a great extent to natural gas lines but I am familiar with oil pipeline practices.

Q Are you familiar with the practice of oil pipelines insofar as providing storage at the refinery is concerned?

A Yes, I think I am.

Q What would you say is the general practice in that respect?

A It varies. The National Refining Company has three refineries all of which are served by pipeline. I can quote those be-

cause I happen to be connected with them. In Kansas the company owned its own gathering system and its own tankage, that is the pipeline division, which is called the National Refining Company of Oklahoma owns the gathering system and the tanks which are at the Coffeyville Refinery and in that case where the company owns all of those facilities, the storage at the refinery is furnished by the pipeline division. At Finlay, Ohio---

Q THE CHAIRMAN: Just there, they are furnished to the parent company?

A It is all the same, it is simply a division of the parent company, at Coffeyville the tanks and the pipelines are all together. At Finlay, Ohio, where we have another refinery, the tanks are owned by the refinery. The pipeline is owned by the Buckeye Pipeline Company, a wholly separate company, and the services furnished by the Buckeye Pipeline Company include delivering the oil at the inlet valve of the company's tanks. There is no storage included in their carrying.

Q In other words then, the general practice is controlled by the peculiar circumstances which surround each individual case?

A That is right.

Q And is it not true also that pipelies as a general rule wish to maintain the very minimum amount of storage which it is possible to maintain and still carry on their operations?

A Well I cannot answer that question because I, I cannot answer it from experience. I presume that they would carry what tankage was necessary to conduct their operations and no more.

Q I would like to ask you this question also in that respect, as a general rule if a company wishes to go into the storage of oil, is it not true that it is generally done through a purchasing company rather than through the pipeline itself, in other words a separate organization is set up for the purchase of oil and the storage of oil and the pipeline, they attempt to keep the pipeline purely as a carrier of oil and not a storer of oil?

A Well that was true in the days of the Prairie Company, That is the Prairie Oil and Gas Company, where it purchased and stored and the Prairie pipeline, where it only transported. Now there are other similiar set ups.

Q Stanoline is one?

A Yes.

Q Humble?

A I cannot say, the Humble pipeline, what their practice is, I do not know whether they store or not.

(Go to number 2585)

Q Is that true of Continental?

A I do not know about Continental.

Q MR. FRAWLEY: There are just one or two things Mr. Hill, I was talking to you this morning about whether or not there was any difference in fact in the practice of receiving crude oil at the East Calgary Refinery and storing it and receiving naphtha at the East Calgary Refinery and storing it, because you made the statement that your information was gathered from the officers of the Company. Now we have here a statement filed by Mr. Moore, Exhibit "79", and is a statement by the Company of its storage at various times. I only want to call it to your attention now for the.....

THE CHAIRMAN: As furnished to the Conservation Board?

MR. FRAWLEY: No, not this statement, Exhibit "79". It is prepared for Mr. Cottle, as Commission accountant, by the Company, for our purposes here.

Q That shows that they have storage for Turner Valley crude oil, for Turner Valley separator naphtha, and for Turner Valley absorption naphtha.

A That will speak for itself.

Q And the statement on Page 16 that naphthas are not stored but are delivered direct to the Refinery, you would not desire to insist upon, of course?

A I think that is true that they are not stored for the Pipe Line Company, it has not anything to do with the storage of it. It is delivered direct to the Refinery and they may use it or store it. I take it

from this statement it stores some.

Q Is there any distinction in fact between you and Mr. Moore, the refiner, that he takes and receives and stores his napthas and takes and receives and stores his crude oil?

A You will have to ask him about that. I do not know.

Q If that were so as appears from that statement Exhibit "79", then I am asking you should he not be asked to look after his crude oil at his own expense just as he is now looking after his naphthas at his own expense?

A The whole of that matter is one of the policy of this Company that I have no desire to discuss. I do not know anything about it.

Q There is only one other thing. On Page 24 you are discussing the risk that is involved in this business and that their return must be commensurate with the risk, and you are dealing with the business today and you say something about Illinois crude coming in?

A No, I simply mentioned the Illinois crude to show what it had done to the oil situation in the United States.

Q You did not intend that.....

A I felt I made that perfectly clear. It was not a parallel case, but simply showed what a destructive effect on price structures the bringing in of new flush production close to markets had.

Q You are not able to point to anything - I want to get as much value from your evidence or opinions upon all these things while you are here, Mr. Hill - you point out there is danger, inherent danger, I take it, of this through put declining in this pipe line?

A I think that is a fair statement.

Q And you base that on what?

A On the fact that this Province, these Prairie Provinces, form, you might say, a closed market. At the present time that market is supplied essentially by Turner Valley. I am told and I read in the papers - I am told by people who should know and I read in the papers there is considerable exploration for crude oil going on in this Province. I know that to be a fact. I am fairly close to the people who operate the Calgary Gas Company and they have told me that they are very much encouraged by the development to the North in the way of oil. I also understand that there is other exploration going on in this Province particularly, and I am quite of the opinion that the possibilities for oil in this Province have not been fully explored and that the chances are, just the law of chance in the oil business, that one of these days Turner Valley will have competition.

Q Yes. Then you are not going outside of the Province. As you say we have a prairie market, and that is ours, but you do not see anything much beyond that for us at the moment?

A No.

Q And then you say that Turner Valley will have to share that prairie market with the newer fields in Alberta, that you think might come in?

A Assuming all the time you will be able to keep out the Montana crude.

Q At the moment you are simply just offering these observations of a speculative nature, and you think

I think that is a fair [illegible].

[illegible]?

or [illegible] at that this Province, these [illegible]

[illegible] might say, a closed market. At the [illegible]

[illegible] is supplied essentially by Turner

[illegible] in the papers - I am

[illegible] read in the [illegible]

[illegible] considerable [illegible] crude oil going

on [illegible] this Province. I [illegible] fact. I am

[illegible] close to the people [illegible] the Calgary

[illegible] they love [illegible] they are very

[illegible] by the development [illegible] in

the way [illegible]. I also understand that [illegible]

for exploration going on in this Province particularly,

[illegible] the opinion that the greatest [illegible]

[illegible] in this Province [illegible] been fully [illegible]

and that the chances are, [illegible]

[illegible], that one of these days Turner [illegible]

will have a [illegible].

Then [illegible] are not going outside [illegible] province.

[illegible] you may [illegible] have a [illegible] market, [illegible] that [illegible]

[illegible] you do not see anything [illegible] that [illegible]

[illegible]

they should be kept in mind in striking a rate?

A Yes.

Q At the moment the fact is, up to now there has been no other crude developed which constitutes competition?

A That is true.

Q You just put forward the likelihood or the possibility. That is as far as you would go is it not?

THE CHAIRMAN: Oh yes, he has said so.

Q DR. BOATRIGHT: I have just one or two more questions. In connection with these possibilities, in the event a pipe line were put into Vancouver, or run the other way, disregarding the economic feasibility of it now, there is also the possibility that there might be an increase in the demand for crude in this Province, is that not true? In other words when we go into the realm of the future there are lots of possibilities that can be seen, one offsetting the other, is that not true?

A I think you have fairly definite statistical figures for concluding your local market demand, that is as the population grows and the quality and extent of the crop, all have a very definite bearing on the amount of crude you may use in these Provinces. That can be more or less approximated but you cannot tell what the drill is going to find.

Q That statement is perfectly true if you limit yourself to a particular area. But do you know whether or not it is true that there are several schemes on foot at the present time to put in pipe lines, either to

Vancouver or to the other Coast or not?

A I do.

Q In that event this market would open up would it not?

A No, because, let us assume we send oil from the Turner Valley field to Vancouver. Now that line would not supply the prairie Provinces at all, because there is nothing much West of Calgary, that is when we get across the Divide we are in British Columbia, so that all that line would do, assuming it were practical economically, would be to increase the productio of the Turner Valley field, and to shorten its life.

Q And increase the amount through this pipe line?

A Not through this pipe line coming into Calgary.

Q Why not?

A Because the oil will go somewhere else. There would be different facilities altogether. It might presumably increase the load and the investment in the gathering system, but as far as the trunk pipe line, it would have no effect on that. Assuming the line went to Fort William or to Port Arthur, it would have a definitely bad effect on the earnings of this pipe line, because some oil shipped through this pipe line is re-shipped by railroad to refineries which would be along the route of any line from Turner Valley to Lake Superior. For instance, the refineries at Moose Jaw, Regina, Brandon and also Winnipeg. All that business would then come off this Calgary line.

There would be no point in shipping it twice.

Q The point I am making is this, there is a chance that the general demand will be built up which will take care of the possibilities of other pools being brought

in. In other words, these two things offset each other.

A I cannot say that at all. I cannot see how an oil line to Vancouver can have any effect whatever on this system coming into Calgary. I think that a line from Turner Valley to Lake Superior would have a definitely bad effect on the shipments, on the present rate of shipment of this Calgary line.

Q Will you grant this, that if a pipe line is put in from this Province to Vancouver, that then a new market will be built up for oil from this Province?

A Indeed it will.

Q All right. Now there is also, as you say, a possibility that other oil fields will be brought in in this Province, which otherwise would come into competition with Turner Valley crude?

A That is true.

Q Now then the question I am putting to you is this, is it not reasonable to assume that the possibility of a line to Vancouver opening up new oil sales, that possibility offsets the possibility of additional fields being discovered in Alberta?

A I do not think so, because I know the conditions and we all know the conditions with respect to the oil market on the Pacific Coast. It is inconceivable to me how any Alberta crude, at present or in the near future, could possibly be transported to the Pacific Coast at a price which would permit of its meeting the California competition.

Q You know, do you not, that it is possible, if the tankage were available, to ship gasoline from Texas

[illegible]

[illegible] old [illegible] only [illegible].

[illegible] you [illegible], then [illegible] in

the [illegible] sides to [illegible], that th[illegible]

broken [illegible]

Indeed [illegible].

[illegible]

around through the Panama Canal, and sell it in Seattle in competition with the oil from California and make money on it?

A Seattle is on the Coast. You take coast points that can be reached by tanker, they are very close together. They are not geographically but price-wise they are. But now we are talking about shipping Alberta crude across the Continental Divide to Vancouver, and having it compete there with California or other crudes which are available by water shipment. I just do not think that is economically feasible. Certainly I do not think the chance of that line being built is at the present time equal to the chance of additional oil being discovered in this Province that will disturb this price situation.

Q Would you give the possibility of that line being built a chance of 1 to 40?

A I had not thought of it that way. I have made estimates on it and I cannot see how it will work. Your guess is as good as mine.

Q Do you have any idea of the average possibility of the discovery of oil by wildcat wells?

A I have not reduced that to mathematics. You are far more competent than I am to do that. But I do know that there are high hopes in various quarters of commercial oil being found in this Province other than in Turner Valley. Now, if that happens, I think the earnings of this pipe line will be seriously affected.

Q Providing no additional market is obtained for that oil?

A Right.

Q I am coming back to this Interstate Commerce Report which has been marked Exhibit "99", and in connection with the figures which you have presented the Commission concerning the size of these lines, the length of the gathering lines and the length of the main lines and the quantity of oil shipped during a particular year. For purposes of comparison is it not true that in comparing pipe lines, that all the various elements that go to make up the economic operation of a pipe line must be considered in making any true comparison?

A Yes, that is true.

Q Would you enumerate the various things that must be taken into consideration by any one attempting to compare pipe lines such as you have mentioned?

A Well the investments, the volumes handled, the operating costs. I cannot think of any others.

Q Taxes?

A Taxes. That is part of the operating costs.

Q The length of the gathering lines and their proportional part to the total amount of line system?

A That comes in.

Q The amount of oil each individual well makes?

A That gets back to the number of connections to the gathering system, yes.

Q The type of oil that is moved?

A To a minor extent.

Q The amount of storage that is provided either through regulation or through their own policy?

A That is true.

Q In other words there are a great number of factors that

[illegible]

must be given critical consideration in making any comparison of the pipe line rate, is that not true?

A If you attempt to fix one rate on one pipe line simply because another pipe line has the same rate, of course that would be an error. You cannot do that. All I am trying to show here is that generally speaking in the United States the rate for gathering and short-haul transportation of Companies that are generally similar do not depart materially from this rate here.

Q However, there are rates - that lines comparable on the same basis as which you have used, those lines that do have rates as low as $7\frac{1}{2}$ cents?

A I do not know of any line with a combined gathering and transportation rate of $7\frac{1}{2}$ cents, that would compare with this. There may be.

Q You would not say there were not?

A No, I would not say there were not.

Q Is it not also true that the majority of short pipe lines, such as those you have mentioned, that their rates have not been reviewed by a competent Commission, where all the facts are brought out?

A I think that is true. I know of no gathering rate that has ever had a critical review.

Q In other words then, the mere fact that the Company has put a charge on, puts those charges more or less in the same class as the Tariff which was originally put on here by the Royalite, and changed from time to time at their discretion.

A Yes. They are fixed by the Company, in accordance with general practice. If there are no complaints they are put in effect.

THE CHAIRMAN:

Q That is true of the three companies you mentioned in your report?

A I think that can he fairly said to be true.

Q Is it two you said were handling oil for the parent company?

A I do not want to make a general statement. I do not know. I know the Toronto pipe line in Montana handle oil which it purchases, and handles it on account of its parent company. There may have been some small exceptions. In the Arkansas pipe line I think for the most part it transports oil which either it or one of its affiliated companies owns. There may be exceptions. The same thing holds true with the International.

Q All three in the same category?

A There might be exceptions. I do not want to tell the Commission that is so because I do not know enough about it.

Q That is the best knowledge you have, however, with respect to the three companies you have mentioned in your report?

A Generally speaking they carry their own oil.

Q Their rates have not been the subject of review by any regulatory body?

A I would not want to say that.

Q You do not know of it being so?

A No, I do not know of it being so or not being so. I would say of its gathering rate I would be surprised if it had been reviewed.

Q MR. COMMISSIONER LIPSETT: Mr. Hill, this figure of $1,700,000.00 that you gave. You gave that as

the value, the reproduction value at the present time, at the end of the year. You also gave as the other extreme a value of about 10% was that, scrap value of the system?

A No, I did not make any calculation of scrap value except on the rate of 5% at the end for salvage.

Q 5% to 10% you said?

A Yes.

Q In the difference between those two values, is there any factor that enters into that except profits derived from through put.

A I am not quite certain that I understand your question just as you worded it, but I think I know what you have in mind.

Q I perhaps might make it a little clearer. I am not trying to put a catch question. If there were no profit or no through put providing profits, the value of this concern would be its scrap value?

A Salvage value. When this company ceases business, ceases to operate, it will then only have what can be realized from the disposal of the materials left there, a salvage value.

Q As against that today in your opinion it has a value of $1,700,000.00?

A Yes.

Q What I am asking you on that is, does not that depend exclusively on profits?

A No. Well you mean any extent of profit? I feel as long as it has earning power and is a live business, it must be considered at a value somewhat in excess of its bare bone value. That is it has component

costs making up this physical plant. Because it is alive, organized and going.)

Q What I was trying to put to you and investigating a little further was, that its value, whatever its amount, really depends on the pipe line rate and the profits accruing from that?

A No, I have made no attempt to capitalize earnings, because I do not know what the earnings are going to be of this Company after the rate has been fixed. I assume a rate will be fixed fairly, and the Company will be allowed to earn money.

Q You are assuming at the moment a 15 cent rate?

A I made no assumption of a 15 cent rate. I have said I think a 15 cents rate is reasonable but I do not tie my $1,700,000.00 back to the 15 cent rate.

Q But you do figure it out on that capital a 15 cent rate will give you 13.3% profit?

A Yes, but I do not tie that 13.3 back to my $1,700,000.00, and say if it does earn 13.3 it is worth $1,700,000.00, and if it only earns $10,000.00 it is less. I have not made computations. Because as long as it can stay going and alive, with earning power and earnings, whatever the earnings may be - assuming they are fixed lawfully and properly, then I say that property has a going value.

Q Suppose a rate were struck, or the conditions were such it could only earn $100.00 a year net profit?

A I would give it very little going value then, because that would be the end of earning you might say. It has then no earning power.

Q Does not that bring your capital structure back to the

scrap value or approximately the scrap value?

A If it never could earn it would have nothing then.
If it never could earn it would not be worth having.

Q It would be just scrap, junk.

A It would be just scrap.

Q Does not that bring you back to what I was putting to you that your figure of $1,700,000.00 really depends on the earning capacity which depends on the rate?

A It depends on the rate being fixed at a point that will permit of the Company earning a reasonable sum. If it has that it is all it can expect. But I have not capitalized the earnings in giving my $1,700,000.00. I have added up my physical property and I have made no allowance for the fact this Company enjoys these utility services, but I say on account of the fact that it does enjoy these services, and because it is a live institution with earning power, it has a value in excess of the figure shown in the two columns I have listed there. I have made no attempt to capitalize earnings. If we were to capitalize earnings over the past period we would arrive at an entirely different figure, depending on the rate of capitalization we use.

Q Let me just try and work it out in my own way. We are agreed on this. If the earnings were only $100.00 your capital value would disappear.

A If that is all they could ever pay, with whatever management and whatever skill?

Q Yes.

A Scrap value.

Q Scrap value. Then if the earnings were say $100,000.00 a year, that is the net earnings?

A $100,000.00?

Q Yes?

A It would have earning power then.

Q It would have earning power then, and in that case on your three years' basis would not that bring us to a capital value of about $300,000.00?

A On a capitalization of earnings' basis, yes, but I did not use that.

Q I am not tying you down to your figures, but I am trying to think it up and work it up with your help?

A If this property could only earn $100,000.00 a year, its going value would only be 6% for instance. It would still have many elements of the going value. It would be alive. It would have earning power, and I think it would be considered substantially as I have considered it there, because I have not added anything for capitalization of excess earnings.

Q Do you say that the figure would be the same whether the earnings were $100.00?

A No.

Q Or $100,000.00?

A No.

Q Or $400,000.00 or whatever it is?

A I say it would ~~have~~ made no difference in my going concern figure there as between $100,000.00 and $400,000.00, because those are both - $100,000.00 is roughly 6%. You can fix a 6% return here and I do not believe you would be confiscating the Company's property. But I have not attempted to capitalize any earnings whatever. I assume the Company has earning power and that a fair rate will be set by whatever body sets the rate and the Company will be permitted to exist and earn money.

Q Well, supposing the facts were that say two hundred or three hundred thousand dollars capital were originally provided for this company and that all this other superstructure has come out of this rate in the past, would we be treating the company fairly to give them the full return on their $300,000.00?

A And no more?

Q And wish them "Good luck" in the excess they have got in the meantime?

A No, sir, you would destroy whatever going value the company might have by that attitude. You would, in effect, confiscate $1,300,000.00 of this company's property.

Q Would it not be equally justifiable to say that in the past the company had, I will not use the word "confiscate" but had received that similar amount from the producers of oil in this Valley, owing to the fact that they had a monopoly and that there was no other means of getting the oil away?

A I think your Honours will have to settle that question, sir. I know what the law is in my country but I do not know what it is here, but I will leave that to the profession, the legal profession.

Q You do not think you can give us any help?

A I have my own opinion upon it but I think it is entirely a legal question and I did not include law in my education.

Q So far as I am concerned, Mr. Hill, I am just putting it to you?

A I have my own feelings about it, which I have expressed to you, that if you take such action you would confiscate $1,300,000.00 of the property of this company which it owns, no matter where the money came from it is this company's property, the legal title.

Q Would that state of confiscation exist if they got a profit of $100,000.00, instead of four, I think you dealt with that a moment ago?

A I say if you, in my opinion, and you know in the law my opinion is worth nothing ......

Q I am asking for your opinion?

A In my opinion, if you take any account of the excess earnings that this company has made in the past, that is an adverse account, you will be confiscating, in effect, the property of this company.

Q But should we pay them or should we suggest a rate that will give them from 13 to 22% return on that money for the future? They did not have to provide it themselves or anything.

A They didn't what?

Q They didn't have to find it themselves, it simply came out of the rates in the past?

A But they have found that money, they have chosen to re-invest that money in Turner Valley.

Q Which they have received from the wells, and from the public?

A They have received from whoever paid it to them, now......

Q Yes?

A Now, when they received that money it became their property to do with what they saw fit. They could have taken it completely out of Canada if they had chosen. They didn't choose to do so, they put it back in this plant and it is their lawful property, and I can only repeat, if you adversely affect this rate by reason of excess income in the past you have in effect confiscated that company's property which it lawfully owns, in this property, that is my opinion.

Q Well, assuming that just for the moment, is not all element of risk gone, or is it?

A This company has been very fortunate in the past, but there is one thing I want to point out to you, and that is that its past earnings came largely from other services than transporting crude oil.

Q We are dealing with the pipeline division only?

A Yes, I know.

Q And not with the rest of it?

A From transporting these naphthas. That day is gone.

Q Well, I just wanted to get your view, Mr. Hill, thank you for it.

Q THE CHAIRMAN: Can you transport naphtha more cheaply?

A No.

THE CHAIRMAN: That is all, thank you.

Q MR. FRAWLEY: Just so we understand your use of the word "confiscation", you say that such a case would be confiscating the property of the company, do you mean these past earnings?

A No, I say this, that if you refuse to permit the company to earn on the property which it now has, however that property may have been paid for, whatever source the particular dollar came from that bought that, you are declining the company a return on its property, you are destroying its value and, therefore, you are confiscating it; in effect, you are depriving the owner of the lawful use and enjoyment of that property again.

Q I see what you mean, the earning power?

A You are destroying its earning power.

Q By puttings its earning power down to a place below which you think it should go, that is destroying the capital

value?

A Yes.

Q DR. BOATRIGHT: Mr. Hill, in effect, instead of destroying the capital value of that $1,300,000.00, which you mentioned, you are destroying the whole capital value, are you not, by that procedure?

A Well......

Q In other words, let me put it this way, in the event that the company's $1,700,000.00, of which $300,000.00 represents new capital that was taken from some source other than the p earnings, and that $1,400,000.00 was taken from past earning and a rate was put in on the basis of that $300,000.00, then, in fact, that would be confiscation of the whole $1,700,000.00, would it not, rather than the $1,300,000.00, because it would put the whole business into the position where it would have to cease?

A Yes, would have to cease, because you cannot destroy four-fifths when it comes to a business and try to support a business on the earnings of the remaining small fraction. Practically, you are right. Theoretically, $300,000.00 has not been destroyed technically, but practically it has. You cannot separate a piece of that business and say "Operate that and not the rest".

DR. BOATRIGHT. That is right.

Q MAJOR LIPSETT: But is that quite sound, supposing the whole business as it is to-day, was earning not $800,000.00 but $200,000.00 or $100,000.00, or any sum you like, that would not destroy anything, would it?

A You mean if this company......

Q Over and above its expenses, if over all its expenses, let us take $200,000.00......

A I do not believe it will earn very much more than that next year.

Q But that is not the point?

A No, you are not, you are permitting an earning of $200,000.00 on a figure of a million or anything like that, you are not confiscating the property, but I say if you wipe out whatever capital is in here from past earnings, then you are confiscating it.

THE CHAIRMAN: There is this much, Doctor, if it is necessary to confiscate property in order to do justice we will confiscate it, is this really in point, Mr. Frawley?

MR. FRAWLEY: No, I do not think so.

WITNESS: I did not seek this argument, I have just tried to answer the question.

MAJOR LIPSETT: Yes, I understand, and you have done so freely.

THE CHAIRMAN: I think we will take a short recess now.

(A five minute recess was here taken.)

::::::::::::::::::::

KENNETH MORRISON, having been recalled, examined by Mr. Frawley, said:

Q Mr. Morrison, Major Lipsett asked you some questions the other day and probably before you resume your own report are you able to deal with those matters?

A Yes, Mr. Frawley, at least some of them. Major Lipsett enquired from Dr. Boatright with regard to the pipeline losses in the years 1933, 1934 and 1935, during which period it appears there were certain commodities from which no deductions were made and I have that information on page, the statement is statement No. 26; from the period of 1933 there were 183,559 barrels of absorption naphtha, from which no deductions were made for line losses. Now, had the usual 3% deduction been made at that time it would have amounted to 5507 barrels, with a value of $16,113.98. Now, it will be recalled that during that period the Imperial Oil Limited took the oil as delivered irrespective of whether it was more or less than that which they had paid for. Had the deduction been made the loss would have on this statement appeared to be that much less, but it would not have affected the relationship as between the two companies. The naphtha in question is all that of the Royalite Oil Company. Now, they did not make any deduction on that 183,000 barrels.

Q MAJOR LIPSETT: Was the effect of that then, Mr. Morrison, that they threw this loss over on to the Imperial?

A That is true, sir.

Q And the Royalite got the benefit of that?

A Yes, the Royalite Oil Company, by not having any deduction made, and in the year 1934, so that you may have the figures,

sir, the deduction would have amounted to 11,738 barrels or a value of $29,365.89. In other words, it would have been greater than the actual loss which was sustained.

Q In that year if the deduction had been made instead of the Imperial showing a loss of $19,000.00 the Royalite would have shown a gain of $29,000.00?

A If it had been so absorbed the same way.

Q The same as the others?

A Yes, and in the year 1935 the figures are 3,174 barrels, with a value of $7,410.69.

Q Which again would have shown a profit to the Royalite?

A Yes, it would have shown a profit to the Royalite had there been an adjustment on the same basis as they are now adjusting, that is to say, they are making deductions from all products, whether it is their own or purchased from some other company.

Now, the other question, sir, was in connection with the capital investment for the years, 1936, 1937 and 1938. Now, I do not know, sir, whether the information contained in Exhibit No. "100", which has just been submitted by Mr. Taylor, will supply what you had in mind, but I will just refer to it; on page 5 of Mr. Taylor's report they show the net profit for the period of seven years and nine months ended 30th September, 1938, of $1,149,222.37, and of that amount there was re-invested in the business in the form of net additions to capital assets $834,000.53. The balance of the net profits which was not re-invested in capital assets of $315,221.84.

Q MAJOR LIPSETT: That will give them a profit of about $45,000.00 a year, plus $834,000.00 of new capital back into the business?

A Approximately that, yes, taking eight years in round figures it would be $40,000.00 and $320,000.00. There was $315,221.84;of the net profits over and above depreciation there was $834,000.00 reinvested in the business, leaving profits over and above the investment of $315,000.00.

Q THE CHAIRMAN: Would it be possible, I suppose it would be no trouble for you and Mr. Taylor to make a tabulation of what was invested by this company in its pipeline division at the very inception of the company, and thereafter year by year what, from that beginning what capital investment was in fact made and secondly, what profit or loss, as the case might be, was made by this company year by year from the time of the starting up of this pipeline business in respect of pipeline matters?

A Well, the first portion of it, sir, that is the investment year by year, I think could be fairly readily ascertained. There are certain difficulties there. For instance, would one include in that figure assets which may have been purchased or put into the system and have since gone out and are not now in use or would those be eliminated as we come to them?

Q I think they should be in, with a notation that they are not now in use?

A Very true, then with regard to the second portion of ascertaining the profits of this Division; now, Mr. Taylor's statement goes back to 1931. Our statements commence with 1934. The records of the company prior to 1931 are such that it is quite a task, in fact almost impossible, to accurately determine the net profits of the company without a very large amount of work, sir. We could

ascertain the gross revenue of the company during the whole period but there are certain expenses which, of course, must be allocated to those revenues and for prior to 1931 it is a very, very difficult task.

Q Well, prior to 1931, what is that, five years?

A Five years, sir.

Q You say that the company's books do not show in the five year period whether or not its pipeline operations operated at a profit or a loss?

A Certainly the books do not show. Now, I do not know whether the statemente which have been referred to here as "Jersey statements" were prepared back to that period.

MR. NOLAN: I cannot say.

WITNESS: That would be the only source which might give some indication as to what happened.

Q I mean to say, we have had a lot of talk about profits to-day and if they are ever to be reflected in a rate and under some theories they might be, it would be most unfair without knowing as to what the situation was in the first five years, they might have been operating at a great loss.

MR. FRAWLEY: If Mr. Burns were here and he could tell us, and we should be able to find out if these Jersey statements were prepared going back to 1926,

Q MR. FRAWLEY: If you had those, Mr. Morrison?

A It would be some indication, but I would not suggest that that would be an accurate reflection of what the company or ourselves, if it was possible to get the figures, would suggest were the profits for those years.

Q But it would be something useful?

A Yes.

[illegible]

[illegible]

THE CHAIRMAN: It might be well to bring Mr. Burns back.

MR. FRAWLEY: Yes.

THE CHAIRMAN: He is secretary of this company and if he cannot say whether the pipeline division of his company operated with a profit.....

MR. NOLAN: He cannot say that for 1938, sir, and that is the whole problem that has confronted these auditors, and that is to break down these indirect costs to show for the purposes of this Commission whether it was a profit or a loss.

THE CHAIRMAN: I can see that might be a difficulty, to show how much was the profit, depending upon how you allocate it, but I did not understand him to say, and did you, that there was a possibility that he operated this division at a loss?

MR. NOLAN: No, but then there is the question of the amount of the profits over all these years from the beginning right up to this time, and it is nobody's fault.

THE CHAIRMAN: Perhaps not, but I just wanted to know whether Mr. Burns could say, and you might call him for that purpose, whether or not he operated at a loss or a profit. If he does not know how much profit or how much loss, that is another matter, but he surely should have some idea whether he operated at a loss or a profit.

MR. NOLAN: You were asking for the profits a moment ago for the early years?

THE CHAIRMAN: I understand that is very difficult to ascertain and might involve a great deal of work. Well, it may or may not be worth while, but I think it is

worth while trying to ascertain whether in the opinion of these responsible officers this company in its pipeline division operated at a loss or a profit.

MR. FRAWLEY: And that would only be with respect to the period prior to 1931 ~~because with~~ Mr. Taylor's work now you are able to say, are you, what profit they made in 1931, 1932, 1933, 1934, 1935, 1936, 1937 and 1938?

A Yes, and I think that other portion, sir, if it was satisfactory to know whether it was a profit or a loss and not ascertaining a definite amount, then I certainly think the officers of the company should be able to say that for the record.

Q MAJOR LIPSETT: Approximately the profit, because, Mr. Frawley, there might be the situation even on this view of the case, that in the first several years the company was spending a great deal of money?

MR. FRAWLEY: Yes.

MAJOR LIPSETT: Running at a loss for the purpose of building up the business?

MR. FRAWLEY: Yes.

MAJOR LIPSETT: And it might be said that we should take the profits into account, and if we did it wouldbe only fair to take the losses into account, in considering the building up of this very fine business which they have now got.

MR. FRAWLEY: Quite so. We will do the best we can and talk to Mr. Burns.

THE CHAIRMAN: And it may be that this Commission will conclude that neither one nor the other should be considered, that is neither losses nor profits, but we want

the record complete and not just one part of it.

MR. FRAWLEY: Quite.

Q MR. FRAWLEY: Now, you were going on?

A Well, now, the other portion of Mr. Lipsett's question dealt with the daily averages of pipeline earnings and that is presently being ascertained, sir.

MAJOR LIPSETT: Thank you.

Q MR. FRAWLEY: I am not clear just as to where you were when you were last giving evidence?

A We were dealing with the statement on pages 2, 3, 4 and 5, and it may be recalled that I was giving a comparison of the results for the period ended 30th September, 1938, on the various bases, that is on the five year basis, from the first of January, on the ten, fifteen, twenty, twenty-five and thirty, and on the basis of the depreciation as shown by the books of the company.

Q Oh, yes?

A And at that point I had some misgivings as to the accuracy of the percentage shown as being the return on investment.

Q Yes?

A But I found that those are quite in order, the confusing part was that this was a nine months' period, that the figures are quite in order, that the return on page 2, for instance, of 57.32% in respect of the earnings for the nine months ended 30th September, 1938, on the basis of depreciation of five years from the first of January is 57.32.

Q MAJOR LIPSETT: Per annum, you mean?

A That is per annum, yes.

Q MR. FRAWLEY: Then you were going to go through

the other year periods and give us just two or three of the figures which you show in your report, as I recall now?

A Well, we had assumed in respect of the direct and indirect costs, - not assumed but had pointed out that the statements were all prepared on the same basis, that is showing the detail of the direct and indirect expenses.

Q Yes?

A Now, these statements on pages 2 to 5 insofar as they deal with the years 1934, 1935, 1936, 1937, are made up on precisely the same basis as the one which I have just referred to for September 30th, 1938, so that those are the comparative figures on the various bases as to profits, net investment and rate of return on investments.

(Page 2612 follows.)

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Q Let me ask you something here which is perhaps obvious, you will remember we were talking the other day about whether this pipeline investment was a proper thing or was not a proper thing, this profit made from pipeline deduction.

A Oh, the adjustment.

Q The pipeline adjustment?

A Yes.

Q Is it clear that that has nothing at all to do with arriving at the cost?

A That is correct, it has no bearing whatever on the cost, it is a matter of revenue and when I spoke of costs it has no relation to the present rate of 15¢ which is being charged nor to the pipeline adjustment which is made possible by the deduction of a certain percentage as an insurance against loss.

Q Nor to the items which you show as added up to on page 2 8.417¢ being the cost on a five year basis?

A That is to say that the 8.147¢ per barrel has no relation, direct relation to the earnings of the company.

Q Yes.

A That is true, that is the cost that it takes to transport a barrel of oil.

Q All right. Now we will just go on.

MAJOR LIPSETT: Mr. Frawley, I am sorry I missed getting that 8.what?

MR. FRAWLEY: 8.417¢ on page 2.

WITNESS; That is the total cost for that charge of transporting a barrel of oil on the basis of using depreciation of five years from the 1st of January, 1939.

MAJOR LIPSETT: Is that subject to this qualification, Mr. Morrison, that the income taxes on that figure is---

A On the 15¢ rate, that is correct, sir, and I want to point out when I come to that statement something that could be quite easily misconstrued as to what the rate should be, that is what the cost would be if the rate were reduced because the cost would be reduced if the rate is reduced in respect of income taxes.

Q Would there be any other figure which would be affected except the income tax figure?

A That is the only figure which would be affected, that is correct, because the income tax figure is the only cost figure which is dependent upon revenue.

Q Yes?

A Now the next statements coming in order are those shown on pages 6 to 9.

Q Perhaps if you take, is there any value in taking the statement on page 5 which is the expenditures and depreciation which are shown by the company itself and putting those results on the record?

A I can make a comparison, I think they have already been put on the record but I will repeat them.

Q You have put them on the record?

A 7.929¢ per barrel as being the cost on the basis of depreciation as taken by the company.

Q Yes, and 8.---

A 8.921¢ represents the net profit per barrel.

Q You say that has already been put on the record the other day?

A Yes, I gave all of those figures.

Q All right, Mr. Morrison.

A Now dealing with the statements shown on pages 6,7,8 and 9, those

in turn are the headings of the statements which we have just dealt with on pages 2 to 5 and probably they can be most easily understood in this way, that we will take the same period for 1938, September 30, on the basis of five years, which is the first basis we have used in each case and the first figure, just using the cents per barrel, it will be noticed that the figure shown is 8.417¢, which is the total cost on that basis for the nine months ended 30th September, 1938 and the profit figure is 8.433¢. That profit results in a return of 57.32% per annum on the net investment on that basis.

Now we come down to the question of a return on investments and this is the first statement where this particular feature appears and we have put on here merely for information the cents per barrel and also the amount involved which would accrue if the company we will say just for the sake of illustration were entitled to 10% per annum on their investment. In this case it would mean, page 6, the cost I have already stated as being 8.417¢; 10% per annum on the net investment would amount to 1.471¢, so that the total cost including the return on investment on that basis a d the cost includes income taxes on the rate of 15¢ a barrel would be the sum of 9.888¢ per barrel. Now that does not suggest that if you have a rate of 9.888¢ per barrel that the company will only receive 10% on its investment, because you see we have still a further element of profit. In other words we have shown a net profit for the year is 8.433¢ and all that this statement purports to do is to take from that 1.471¢ and there is still left a further profit to the company of 6.962¢.

[illegible] the headings of the [illegible] that we have [illegible] with or given to our publicity [illegible] sec- [illegible] reported in this way, [illegible] will take the [illegible] for 1928, September [illegible], or the [illegible] of [illegible] the first [illegible] we have used [illegible] figure, just using the earnings per barrel, it [illegible] stated that the [illegible] shows 3 [illegible], which [illegible] for the [illegible] ended 30th Sept. [illegible] figure is [illegible]. That [illegible] amount [illegible] on the [illegible] basis.

[illegible] come down to the [illegible] further- more [illegible] is the first step [illegible] feature [illegible] and we have put on [illegible] and also the amount [illegible] surplus of the company we will [illegible] depreciation were deducted [illegible] amounts. In this case it would [illegible] already stated as being 8.4176; 10% [illegible] dividend would amount to 1.4[illegible] the return [illegible] Income taxes on [illegible] would be the sum of 9.88¢, or [illegible] that if you have [illegible] 9.88¢ [illegible] that the company will only [illegible] we have still a further element of profit. In other words we have shown a net profit for [illegible] and all that this statement [illegible] from [illegible] 1.4716 [illegible] of 6.90¢.

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I would like to endeavour to make that as plain as possible because that is quite involved. I think probably for the purposes of this illustration we could go right to No. "1". Statement. It has the same figures on it.

Q MR. NOLAN: Let me be quite clear. Our statements No. 2, 3, 4 and 5 were only arrived at by the net profit for the year. We took no consideration of the return on investment at all.

A On 2, 3, 4 and 5? That is correct.

Q We pick out the figures 8.417 and 8.433 from that statement and go on from there?

A Yes, and go on from there. I am suggesting for the purpose of clarity we go to statement No. 1. We will probably find it here illustrated what I have in mind. Using the very first column we have 5 years. The cost it will be recalled, was 8.417 cents. If the Company were to get 10% return on their money - and I have no particular thought in using the 10%, it is just the last one on the page - the cost would be 9.88 cents per barrel, compared to the 15 cents that they collected. In other words there is still a profit accruing to the Company over and above the 10% return of, well the difference between those two figures, approximately 4.2 cents, comparing it with the 15 cent rate. You may recall that the actual revenue per barrel for that year was 16.85 cents because the pipe line adjustment was regarded as an earning. So there would be a profit to the Company still, after allowing it 10% of 6,962 cents per barrel.

[illegible]

Q MR. FRAWLEY: Without drawing you off the track - if it does so you tell me - you could take that 9.888 cents and break it up for us without a great deal of trouble. It was under 5 or 6 heads, what is really in there?

A That represents on Page 2 you will find 8.417 cents, and you find how that is made up. It is made up.....

Q We will just call it that?

A Yes, I will give you each individual item. Direct Operating Cost was 2.806.

Q We are going to break down the 9.888?

A That is correct.

Q And the first thing is 8.417 cents?

A Yes, 8.417 cents has already been given to you in detail on Page 2.

Q We take that as the first one?

A 8.417 cents being the total cost.

Q Yes, 8.417 cents, that is the total cost?

A Yes. The next figure is 1.471, being the interest at 10% per annum on the net investment.

Q That is interest at 10%. In other words we have been calling that return on investment?

A Return on investment . Correct. The sum of these arrives at this 9.888 cents.

Q That is 9.888 cents, would that be the rate. Would that be all they would get, 9.888 cents?

A No, at that rate, allowing them 10% there is an additional profit as well of 6.962 cents per barrel.

Q Under the existing circumstances?

A Under existing circumstances.

Q But this 9.888 cents gives them back their total cost,

including amortization?

A Yes.

Q And a return on their investment of 10%?

A Oh no. That is the point I want to make quite clear. It does not mean that. I have worked out how your particular problem would be solved. The rate on a 5 year basis of 7.921 cents will give to the Company 10% on its investment.

Q I do not know whether this is getting off on side issues, but would you break down the 7.921 cents?

A That includes total cost before income tax of 6.035 cents.

Q Does that appear quite well in your statement?

A I can give you the figure making it up on Page 2 of my Report. You will find cost before income tax of 6.022. That is on Page 2. Then there is a further cost, which is not subject to Income Tax, of .013 cents.

Q That represents losses on sales or retirement of equipment.

A Yes. That gives you a cost, a total cost of 6.035 cents per barrel. Interest at 10% amounts to say 1.471 cents. The Income Tax will be .415 cents, and the resulting total 7.921 cents per barrel will represent the total cost plus a return on investment at 10% on the basis of 5 years from the 1st of January 1939.

Q And what is the difference between that total cost and the rate per barrel?

A That is the same thing.

Q The same thing, all right. That is when you include in

your cost a return on the investment, and that is all they get?

A Those are the component parts of a rate in my opinion, are the total cost, including depreciation and income tax. Then when you add to that the return on investment, at an agreed rate, you have your rate.

Q What you are doing in your statement 1, you are showing what these costs were compared with the actual rate per barrel that they now get?

A That they are now collecting, that is correct.

Q MR. COMMISSIONER LIPSETT: That, Mr. Morrison, is on the basis of the total net capital, on your figure of $897,448.00?

A That is correct, Sir.

Q And this figure that you give, would give them back all that capital in 5 years?

A In 5 years from the 1st of January, 1939. That is correct.

Q And provide Income Tax?

A Provide Income Tax, yes sir.

Q And give them 10% on that $897,000.00?

A That is correct, 10% per annum.

Q In addition to giving them the whole money back again?

A Yes, by amortization. We have dealt with the matter of depreciation on the basis that we go right back to the beginning of time. We disregard the calculations that have been made, and set up a new basis of accrued depreciation. On that basis we find a net book value of the investment as at say the 30th of September, in this case, amounting to $897,448.07. Whenever you change your base you are changing the amount of the

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net investment as will be seen from the statement. For instance the next year it is a 10 year period and the net investment is $1,025,957.63, the reason for the difference being the amount they accrued less depreciation on the longer basis.

Q I understand that. There is this other factor, Mr. Morrison, as well is there not, that you are assuming this, may I call it profit for the moment, this pipe line loss, was that taken on the basis of the experience for the first nine months or on the basis of this reduced allowance?

A It does not enter into the calculations at all, Sir, it is strictly on a cost basis. I merely am showing it is costing them so much money to transport the oil and then I will add to that the cost of the return on their investment at 10%, and then I can compare it with what they have actually got. The difference between the two is additional profit.

Q Yes, I follow now. Then your figure on this basis will be correct, assuming the pipe line loss......

A I do not think it would have any effect whatsoever on the calculations I am making. That is if that suggestion is agreed with, the rate is based on the cost including depreciation plus fair return on their investment. That is the rate they are to get. What they actually get insofar as pipe line losses are concerned may be more or less than that, according to whether you say that percentage of deduction is sufficient insurance to take care of all their losses.

Q You would not put it into costs at all then?

A No, because it had not been an element of cost. Even

[illegible]

[illegible] seen from [illegible]

[illegible] next year [illegible] is a [illegible] year behind

[illegible] investment is $2,020,957.65, the reason [illegible]

[illegible] ing [illegible] second [illegible]

[illegible] longer basis.

[illegible] There is this [illegible]

[illegible] as well as [illegible] not, [illegible] running

[illegible] this [illegible]

[illegible] on the [illegible] difference

[illegible] the first [illegible] basis [illegible] the reduce

[illegible] really are showing

[illegible] which [illegible]

[illegible] that [illegible]

[illegible] they have come [illegible]

[illegible] is additional [illegible]

[illegible] Then [illegible]

[illegible] assuming the [illegible] line [illegible]

[illegible] they have [illegible]

[illegible] ing. That is [illegible]

[illegible]

[illegible] costs [illegible]

[illegible] it has not been an [illegible]

if it had been a loss I would not have regarded it as part of this rating. I would say that would be a matter for the adjustment of the Pipe Line Loss Deductions by increase, if the experience of the Company had been they were losing money in respect of that, than the remedy,is to increase the amount of the deduction.

Q Yes, I see?

A Now the effective rate figures for the purpose of the record, on the other basis, on the ten year basis,- that is to say the total rate which would apply on a ten year basis, and I am just giving the total figures, would be 7.391 cents per barrel. On a 15 year basis 7.10 cents per carrel, on a 20 year basis 7.034 cents per barrel, on a 25 year basis 6.960 cents per barrel, on a 30 year basis 6.911 cents per barrel, and on the basis of depreciation as used by the Company 7.435 cents per barrel.

Q The first figure, Mr. Morrison was 7.921?

A That is correct, Sir.

A MR.NOLAN: That is five years?

A Five years.

Q MR. FRAWLEY: All right.

A I think that deals with all the phases and all the statements that I have presented, Mr.Frawley.

Q Just let us see now?

A It being understood of course, that the same method of preparation has been followed.

Q You really left off at 6. Would you run through 6 and 7, just to say what they are for the record? The next group of statements are 6 and 7?

A And 8 and 9.

Q 6, 7, 8 and 9, yes.

A They are a summary showing the return on invested capital for the years 1934 to 1937, and for the nine months ended 30th September, 1938. I made up Page 6 on the basis of 5 and 10 years from the 1st of January, 1939, and on Page 7 on 15 and 20 years from the 1st of January 1939, and on Page 8 on the basis of 25 and 30 years from the 1st of January 1939, and on Page 9 on the basis of depreciation as shown by the books of the Company.

Q On the basis used by the Company, which is shown on Page 9, what are the figures?

A The total cost, I am speaking now only of the period ending 30th September, 1938, the total cost, which includes all charges and Income Taxes, was 7.929 cents per barrel, resulting in a net profit per barrel of 8.921.

Q Being the difference....

A The difference between the total net revenue of the Company of 16.85 cents per barrel and the cost of 7.929 cents per barrel.

Q Yes?

A The net investment was $965,637.97. That would show a return per annum of 56.36 %. Then the figures are shown as to the return on investments, at rates varying from 6 to 10%.

Q Then we get into the statement you dealt with really when you first went on, is that right, that is Statements 10 to 21, with respect to which......

A From 18 to 21.

Q And you dealt with them in detail?

A That is correct. 19 to 21 I should say.

Q So that we need not go over those again, certainly not in chief anyway. Then the next statement is Statement No. 22?

Q MR. COMMISSIONER LIPSETT: Could I interrupt for a moment. Just before we leave that set of figures which you gave us a summary of on Page 1?

A Yes.

Q Have you made out any statement of the rate on any other basis except 10% on the investment?

A No, I have not. It is quite an involved mathematical calculation to find what the Income Tax is.

Q Yes?

A But any other rate could be ascertained. If we know what other rate would be required we shall be glad to ascertain what it will mean. But this is all based on 10%.

Q MR. FRAWLEY: And Statement 22, have you said in evidence already everything you want to say about that?

A No, I have not dealt with that. Well I may have dealt with it generally. Statement No. 22 is the detail of the Administrative and General Expenses for the years which we are reviewing. In other words, I can show how it ties in with the statements by referring to Statement No. 21. It will be found there under the head of Proportion of Administration and General Expenses, Administrative and General Expenses including Estimated Professional Fees $82,554.82. The details of that figure are found on Page 22.

Q The first item under Administration and General Expenses?

A Is $82,554.82. The details of that are shown in the last column on Page 22.

Q May I ask you just why you did that? I mean you picked out the $82,000.00 and you did not break down any of the others?

A Now, that is a big item in Administration Expense, and in order that the Commission might know how.....

Q What is that vacation expense, $19,688.26?

A Well it is an amount set aside in the Company's books for all Departments. I am not just quite sure what the purpose of it is. It is a holiday or vacation allowance.

Q To look after the extra staff or anything of that sort?

A I am not sure of that.

Q But you did take the $82,000.00 which you thought the Commission might be particularly interested in and you brought it down as shown on Page 22?

A That is correct.

Q For each of the periods?

A Yes.

Q MR. COMMISSIONER LIPSETT: Did that seem reasonable to you as far as you could judge, or do you want to draw attention to any particular item?

A No sir. It seemed quite reasonable. There was no motive other than to show the details of the large figure of $82,000.00, because those details could really have been put in this other statement, but I thought it would be more convenient to summarize them on one statement.

Q Subject to any discussion about percentage allotted, you are practically satisfied?

A Yes, we are satisfied these are correct charges.

Q You are both in agreement?

A Oh yes, it is just as to the percentage.

Q MR. FRAWLEY: Now is that all you want to say about statement No. 22?

A Yes. The same remarks apply for the other years. The details will fit in with the other statements. Statement No. 23 is merely a summary for the purposes of information of the capital investment as shown by the books as at 30th September 1928.

MR. FRAWLEY: Well I do not know that there is any value in finishing with the witness. I am just about through in chief.

THE CHAIRMAN: I think, Mr. Frawley, there might be value in not finishing, because I am sure you will have something more on Monday to ask. We will let Mr. Nolan after he starts continue.

MR. FRAWLEY: Yes.

(At this stage the Hearing was adjourned until 23rd January, 1939).

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J. J. FRAWLEY

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The Province of Alberta

IN THE MATTER OF THE PUBLIC INQUIRIES ACT

—and—

IN THE MATTER OF a Commission, dated the 12th day of October, A.D. 1938, to inquire into matters connected with Petroleum and Petroleum Products

Commissioners:

The Honourable MR. JUSTICE McGILLIVRAY
(*Chairman*)

—and—

L. R. LIPSETT, ESQ.

Session:

CALGARY, Alberta JANUARY 23rd, 1939

VOLUME 20

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J. J. FRAWLEY

I N D E X

Page.

VOLUME 20 - January 23rd, 1939.

WITNESSES:

E X H I B I T S

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. . . .

KENNETH MORRISON, having been recalled, examined by Mr. Frawley said:

Q Mr. Morrison, I have not asked you anything yet about the rate of return which should be allowed, that this Commission should allow to the Royalite Oil Company on its pipeline investment on striking the rate, have you had some experience in the matter of rates of return to be allowed in rate fixing cases?

A The only experiences I have had in the matter of rates, in a rate case, took place in the City of Calgary with a local gas company, the Canadian Western Natural Gas Light Heat and Power Company, Limited, were allowed a rate of return by the Board of Public Utility Commissioners of the Province of Alberta, which was 8½% on the rate base, which was also of course agreed upon as one of the factors necessary to be known. Now that rate of 8½% was confirmed by an order of the Public Utility Commissioners in the year 1931 I believe. I have the order number available.

Q Oh yes, I want to file now, I have in my office either the Alberta Gazette where that appeared, in any event I have something official to file with the Commission covering this order but if you will put the order number into the record?

A The order number was 6327 of 1931.

Q THE CHAIRMAN: The date in 1931, have you got?

A I think probably I have it here, 6327 dated the 20th day of July, 1931.

Q That was the order which fixed the rate which is presently in effect in the City of Calgary for natural gas?

A That is the rate of return.

Q Yes, but I mean is that the current order?

A That is the current order, I am quite of that opinion. I know of no subsequent order to that.

Q And the rate of return allowed to the Calgary Gas Company was $8\frac{1}{2}\%$?

A I might read, on page 13, of the order under "Rate of return" is the following:

> "On the basis of the Board's estimates as to the price of gas, forecasted sales, operation and capital charges as shown in the foregoing table, the rate of return to the company would be 8.45%. The rate of return indicated by the Board as reasonable is $8\frac{1}{2}\%$. It will be seen therefore, according to the Board's estimates the company will be making approximately the rate of return indicated."

Q Yes, now I ask you that question so as to have on record your view with respect to the rate which should be allowed and what rate in your submission should be allowed this company on the pipeline investment?

A Well it would appear to me, I am not speaking now of pipelines other than the present material and quantities, that the conditions are somewhat similar in that the production has been given, possible production. Then we know of the relationship of the Royalite Oil Company to the Imperial Oil Company, which is the marketing organization, the refining and marketing organization and it appeared to me that there was a similiarity insofar as security was concerned between those two concerns.

Q And you would be prepared to submit to this Commission then what rate percent of return?

A A rate of $8\frac{1}{2}\%$. The further material that I had in connection with that is that laid down in the Dominion Water Power Act,

and Dominion Water Power Regulations, in the Domínion Water Power Regulations at page 51---

Q You had better first cite the publication, the witness is referring to the Dominion, to an Act respecting "Dominion Water Power", chapter 19 of 9 and 10 George V, and to the regulations made under that Statute.

MAJOR LIPSETT: You might give us the title of the Act.

Q MR. FRAWLEY: The title of the Act is "An Act Respecting Dominion Water Power" or it is cited as "The Dominion Water Power Act", and Mr. Morrison has here, that which I am sure he would be glad to leave with the Commission, a pamphlet issued by the Department of the Interior containing the Dominion Water Power Act and the Dominion Water Power Regulation, governing water power rates in the Provinces of Manitoba, Saskatchewan, Alberta and the Northwest Territories, printed in 1935.

THE CHAIRMAN: Are you relying on the regulations?

MR. FRAWLEY: Yes.

THE CHAIRMAN: Should they not go in; the Act perhaps not.

MR. FRAWLEY: Yes, the regulations.

THE CHAIRMAN: If you want these as evidence you will have to produce them.

MR. FRAWLEY: Yes, but the Act is there for your Lordship to look at. We will file then Mr. Morrison, and this bears the imprint of the King's Printer, the Statute does and presumably the regulations do too.

THE CHAIRMAN: The regulations will be Exhibit "101" then.

(REGULATIONS OF THE WATER POWER OF THE DOMINION, HERE MARKED AS "EXHIBIT 101").

THE CHAIRMAN: You might read the regulation you are referring to:

MR. FRAWLEY: Yes, would you mind picking out the regulation, Mr. Morrison, the witness is calling the Commissions' attention to Regulation 48, sub-paragraph 13; it is found on page 51 of the pamphlet which we are putting in,

"In the case of a licensee engaged in the sale of power, no upward revision of the rate of the rental per horse-power-year shall be made at any ten-year period if it can be shown that the proposed increase in the rate of the rental will make it impossible for such licensee to earn a fair net rate of return on the actual cost of the physical properties used and useful in connection with the undertaking, after providing for the amortization of and interest upon such costs of promoting and organizing the enterprise, and of providing capital otherwise than as included in such actual cost as may be necessary and legitimate. For the purpose of these regulations such fair rate of return shall be considered to be twice the average percentage yield on the last issue of Canadian Government bonds made previous to or during the year for which the rental is to be determined, such average percentage yield being based on the average of the official Montreal Stock Exchange quotations issued during the year in question".

And I should read sub-paragraph 14.

"The fair net rate of return defined in the preceding sub-section shall be considered as being cumulative from the date upon which the licensee first began the sale of power from the initial development".

Q Now do you want to elaborate on that, Mr. Morrison, as to what that means because it refers to some issue of Dominion

bonds?

A Only to this extent that in our experience in dealing with the audits of Public Utilities Companies, that they have always, the companies have always regarded that they were entitled to a return equal to twice the return which is presently in effect on Dominion Government bonds. That was their general interpretation of that section.

Q And what is that, by the way?

A At the present time---

Q There is a gap in our evidence there?

A The last issue of bonds I have the returns, it varies between 3 and 3.25%, the last issue I think was 3.07%.

Q You said it varied between what figures?

A 3 and 3.25%. I did have the figures if I could just put my hand on them.

Q Mr. Morrison, if you cannot locate it?

A I cannot locate it just at the moment.

Q You can put that in before you step down altogether from the stand, will you remember that?

A Yes.

Q Now, Mr. Morrison, it appears from your report---

Q THE CHAIRMAN: When was the last issue?

A The last issue, sir, was in 1938 I believe, the year just closed. The figures I was quoting were for 1937 and 1938. Now before I leave that matter of rate of return, Mr. Frawley, the only other material which I was able to find, at least I was able to find material in a book "Economics of Public Utilities" by Nash, which is quite a recognized book in the profession and also in utility companies, and that deals with the allowance in rate cases. The majority of those, in fact I think all of them, deal with cases in the United States, in the Courts and before the Inter-State Commerce Commission.

Q Have you a passage you would direct the Commissions attention to?

A There are a number of passages on page 249, there are references made to allowances in rate cases.

Q THE CHAIRMAN: What views are you accepting, which you wish to read to us?

A That the rate of return varies between 6 and 9%, in the Courts there.

Q MR. FRAWLEY: Do I understand that this book contains a review of what rates of return have been approved in, either in litigation or in matters coming before the Inter-State Commerce Commission?

A Certain returns.

Q You might put on the record, if you want to direct the Commission's attention to this book, and I suggest the book might as well be filed and left for the consideration of the Commission of they desire to read that or any part of it.

THE CHAIRMAN: The book itself of course is of no value except insofar as this witness is able to say that he concurs in that. The book cannot be cross-examined but let the witness say what part of that book he approves of and subscribes to.

Q MR. FRAWLEY:- Yes, I would like to put on the record then that part of it which you say contains the material you refer to and which you say you accept.

A Well I want to be quite clear on that, so far as the Commission is concerned, I have no experience of my own in respect to these cases.

Q No, no?

A I am merely using is as being the experience in other cases, rate cases.

Q Oh it is just, I see, then you are simply using it as to what

the facts were in those cases?

A That is true.

Q It is not a view of the economist you are accepting?

A No.

THE CHAIRMAN: Well Mr. Nolan, any objection?

MR. NOLAN: No my Lord, but it seems to me it is a matter which should be brought out in argument when Counsel is before the Commission on that phase of it.

THE CHAIRMAN: Well Mr. Frawley is offering it, do you object to it being received?

MR. NOLAN: Are you going to put in the whole book?

MR. FRAWLEY: Only for what is contained as to a number of cases, showing there that in certain cases such things were done.

MR. NOLAN: No I have no objection.

THE CHAIRMAN: Then it will be Exhibit 102, what pages are they?

MR. MORRISON: Pages 249 to 253.

(BOOK PRODUCED BY THE WITNESS HERE MARKED AS EXHIBIT "102".)

Q MAJOR LIPSETT: And page 259 as well, is that correct?

A No, 249, those are the only pages I referred to.

Q MR. FRAWLEY: Now, Mr. Morrison, if we are through with that phase of the matter, I want to have you discuss one more matter and that is all, it appears from your report that you subscribe to the proposition that, and you so submit I understand to the Commission, that this Commission should take the present capital investment of this company as disclosed by the records in the book, the original cost as you have added it up and then, they should in the rate which they will strike, make an allowance sufficient to enable the company to amortize

that investment over a period of years depending upon what period of years is taken, which in turn as I understand it depends upon the life of the field, that is so, is it?

A That is correct.

Q In other words do you subscribe to the proposition that whatever profits the Royalite Oil Company pipeline division has made up until now that is something which the Commission should not take into account in arriving at the rate?

A Only insofar as those profits affect the accrued depreciation. In other words if I might just elaborate on that, we are not suggesting that the profits of this company should be ignored to the extent of the depreciation which has actually occurred in the plant, the capital assets; in other words the records of the company as presently constituted take for depreciation charges a certain basis. Now it is, we are of the opinion, we concurred with the opinion that if we are going to regard this now as a company whose records are open to regulation, that that depreciation should be revised in order to conform as being correct to what is the correct lifetime and to that extent the profits of this company in the past would be taken into account. Now apart from that, apart from any profits which they had made over and above that, we do not regard that those should be taken into consideration in fixing the rate.

Q Now I want to see that I understand, you first take a period of years?

A Yes.

Q Before you beging making any of these calculations, that is the way you have done?

A That is correct.

Q Take any one you like, take five years, you ignore what the company has done in fact in its books?

A Insofar as the deprecation is concerned.

[illegible] a part [illegible] of [illegible]

[illegible] aspect.

[illegible]

[illegible] in other words, if I might just [illegible] in this, we are [illegible] the [illegible] noting that the profits of this company [illegible] extent of the depreciation which has actually [illegible] the assets; in other words the [illegible] presently constituted [illegible] depreciation [illegible]

[illegible] in order to [illegible]

[illegible] Now [illegible]

[illegible]

Q And you begin again yourself?

A Yes, at the beginning of their operations.

Q You go back to 1926?

A Right.

Q And then you add 5, which is 13 years?

A Thirteen years.

Q And then you add 5 which makes it 18 years?

A Yes.

Q And then you say to yourself "18 years is the figure which I am going to use to depreciate out this company's investment"?

A That is correct.

Q And so you begin at the beginning with the 18 years, is what?

A It is about 5.3% or 5.4%, 20 years is 5%.

Q Say 5%, 5 plus something percent?

A Yes.

Q Then you depreciate beginning in 1926 and disregard for the moment the fact that you have to be careful to adjust your accounts on account of new assets coming in?

A Yes.

Q Forgetting that for the moment, you begin in 1926 and you allow an annual amortization figure of 5 and something percent of the investment?

A That is correct, and then we accumulate that figure up until the present time which in this case would be 13/18 of the total.

Q Yes, now what did you mean when you said a moment ago that that might in some fashion affect the profits of the company?

A That is to say we are going to put a charge in the books to replace the charge which they made against profit; after all depreciation is a charge against profit. Now we are going to supersede the charge which they have made by a charge which we think is the correct one based on the lifetime of the field.

Now then to that extent it affects the profit It does not affect the profits over and above depreciation.

Q No?

A Except insofar as our rate may be greater or less than the rate which the company used.

Q Yes?

Q MAJOR LIPSETT: Would not the depreciation be a charge against capital if there were no profit, it would have to come out of capital, would it not?

A No sir. Depreciation is always a charge against profits, that is from the accounting angle.

Q Yes.

A Now you might have a situation that a company, because of charging depreciation to its account, shows a loss. Then it is open to argument whether or not the company actually received their depreciation because they certainly would not be able to set it aside out of profit that they did not incur but that situation does not occur in this present company, there were always profits to take care of the depreciation.

(Go to page 2635)

Q THE CHAIRMAN: From the beginning?

A As to the amount of profits we are not in a position to state, but I am certainly of the opinion on my observation of the books, there were always profits made.

Q From the inception of the Company?

A From the inception of the Company.

Q MR. FRAWLEY: Just so we can go along further now, the Chairman raised the question the other day as to whether the Company had in the period prior to 1931 - which Mr. Taylor can tell us of in detail - whether it has made profits or losses in that earlier period? I suppose you conferred with Mr. Taylor about that, and you can now say whether the Company did suffer any losses?

A It is my opinion - I do not know whether this is finally agreed upon by the Company, they will speak to that - but I am of the opinion that looking at the accounts, as we have seen them, and realizing that all the entries have not been put into the books which affect the Pipe Line Department, I am of the opinion at all times the Company made a profit. We are not able to state how much profit.

MR. FRAWLEY: I wonder if my learned friend Mr. Nolan could give us an admission as to that?

MR. NOLAN: It had best go on the record through Mr. Burns.

MR. FRAWLEY: Then we will let is rest at that.

Q MR. COMMISSIONER LIPSETT. You are going to make us a statement showing the capital of the Company more or less from the start?

A Yes, a capital statement. The statements which have

Kenneth J. Morrison.

been submitted, the cumulative figure on capital is from the commencement but we are making an additional statement showing how that is worked out year by year.

Q I think your figures differ somewhat to those given by Price, Waterhouse?

A No. In Exhibit "100" Price, Waterhouse have included in their assets those which are not now being used, and we have not done that. I think that will be found as the principal difference.

Q Mr. Morrison, the Company themselves, I understand, allowed that 10% depreciation each year?

A Yes, that is correct.

Q And the answer that has been suggested is that if there were profits made, that it would have been the duty of somebody to go the Board of Public Utility Commissioners and ask for a reduction in the rate if they were dissatisfied.

A If they were under the jurisdiction of that Board.

Q Would it not be brought in, in answer to any reduction in the rate, that the Company had a right to make that 10% depreciation, that they were entitled to do that?

A I do not know, Sir, that that is right to say, because in addition to the right to have 10% depreciation, they were making a profit.

Q Would it be fair to say on behalf of the Company that this 10% was a reasonable rate, and that they should have a rate to cover it?

A They might put forward that argument.

Q And with very great force.

A If they were before the Public Utilities Board and that was, at the outset that was the rate, then in subsequent

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periods that depreciation at that rate would be deducted from their investments. Therefore, they would then only be getting a return on their net investment, which is the gross investment less accrued depreciation at 10%.

Q In this statement that you are making us put, that will only take into account the four of 5 per cent depreciation?

A Yes.

Q And that extra profit would be added?

A Not added as extra profit. I am allowing them to retain that profit.

Q Does not that present itself to you as slightly inconsistent if the answer to a request for a rate reduction at that previous period would be they were right to have that 10% depreciation? It seems to me it would be hard to overcome that objection if anybody went to get the rate fixed in the past?

A No, I do not know that it would be difficult to overcome. My depreciation is recorded by the Company. Speaking of this Company in particular. They are not determined by the thought that they had to account to a regulatory body. I may, for instance, point to the matter of the amount of depreciation allowed by the Income Tax authorities. The Company may decide, and quite correctly, that they were going to have the full allowance as given to them by the Income Tax authorities.

Q In fact that is what they did do?

A That is what they did do. Insofar as the Income Tax is concerned, they would have no objection to that because when the ten years were finished then they would not be

entitled to any depreciation on those assets. So that the Company were not doing anything which was not quite consistent with good practice in taking the 10% return. On the other hand they could have decided to take a much lesser rate than we are now suggesting. Supposing for the sake of argument they did not depreciate the property at all. I would still say insofar as the Company is concerned we should go back to the inception of the Company and depreciate it on this basis, because actually that amount of accrued depreciation has occurred.

Q But if that extreme case had taken place, that there was no depreciation taken, then the profits in the past would have appeared larger?

A Would have been larger, yes sir.

Q And would not probably the natural result be that some dissatisfied transporter through the line would at once go and get the rate or try and get the rate reduced?

A There is this situation insofar as the Company is concerned, there was no statement to show to anybody, to the public at least, what the Pipe Line Department was making in the matter of profit. The statements which are made out show the operation of the whole organization.

Q Yes, and might not the public get the idea, and a very reasonable idea, that this was a somewhat speculative venture and the Royalite Company had to get their money back in a reasonable time?

A Yes.

Q The time they themselves fixed being 10 years?

A That is true.

Q You do not think we should give any account to that?

A It does not seem to me that it would be, at least not in

my view - that it would arrive at an equitable result insofar as the Company is now concerned, bearing in mind the fact that they were an unregulated Company.

Q They were a Company with very strong compulsory powers to run a pipe line any place that was necessary whether anybody objected or not?

A Yes. Insofar as accounting is concerned, I may say that this is the usual method adopted.

Q I see that book......

A That is the only one I am personally familiar with and that is the Calgary Gas Company, it is the same method that was adopted.

Q I still have this fact present to some extent in my mind, and I would like to see it cleared up in some way. If we first of all give them this 10% or they took that say?

A Yes.

Q And that we be asked, or whoever be interested in it, say it was reasonable that they should get some of their money back in ten years, I mean when this comes up, if we go away from that basis we are giving them that money twice over?

A I can quite appreciate that viewpoint. I think it is a very real difficulty. By the way that is mentioned in several of the text books in connection with rate cases, that that is the big problem which a Commission has to face, that fact that the Company has apparently got back by way of depreciation 50 or 60 per cent of its capital and then successfully argues before the Commission it should then get back a further 90%.

Q And it becomes still more pressing from this point of view that if Dr. Link's view and Mr. Davies' view of two or three years, as a safe margin was in the Company's mind, the sure margin, they might be even getting an extra rate so as to cover that risk and that the public might be accepting that knowing that the risk was correspondingly great.

A That is quite true. Now looking at that from past experience, of course, it is very much easier to say "Well they may have thought that at that time, and because they were quite wrong, and because this field is not going to be finished in two or three years," then on the other hand would it be, I was going to say fair, to suggest that the Company were not sincere in thinking that that might be the situation and adjusted their rate accordingly.

Q Assuming their sincerity?

A Yes.

Q Assuming they adjusted the rate accordingly, they then in fact have got the major part of their capital or the whole of their capital back, haven't they?

A If you regard, or if you tie them down to what the accounts show, insofar as accounting is concerned, that is quite correct. But if you will also keep in mind that the profits are really divided into different workings of the Company, and the Company have said in their accounting system "We have got 10% back for depreciation and the rest is profit." Then the other viewpoint is that they have not got their investment back and they have made more profit. If the

Company are to be held down to what their accounts show, then that is the situation that they have got by way of depreciation all their invested capital and in addition to that a certain amount of profit. The view we are suggesting is that they have got less back by way of depreciation and have made more profit.

Q And in this return you are making out for me, at least that I asked you for, you are placing it on a 10% depreciation and I think you were going to base it on 10% return on the month, from the start?

A Yes. Well from 1926. You asked the question, Sir, about getting the capital for the years 1936, 1937 and 1938?

Q Oh no.

A And the CHairman asked the further question about getting the capital structure made up year by year from the inception?

Q That is what I was interested in. It was 1926 I was thinking of, from the inception of the Company down to date, and allowing this 10% return on the money, and 10% depreciation for that period.

A Well now.....

Q Well now, perhaps I did not make it clear.

A On Page 2342 of the transcript, no Page 2141..

Q Just before you read it, Mr. Morrison, you are quite correct in this, I was asking for the picture in this last two or three years, when the large capital outlay was made?

A Yes, and the Chairman has requested a further statement showing what the capital structure is year by year, and that is being prepared.

Q And you are going to make that on the basis of depreciation that the Company themselves took 10%, plus 10% on the investment all the way through?

A Of course, that really is shown in one of these statements, that particular phase of it. That is while we have not got the detail of the investment year by year, yet we have the cumulative effect of it. Now I want it quite clear, in all of these statements, as far as depreciation is concerned, they all go back to the inception of the Company.

Q I know but they do not go back to the original capital that was put in?

A Oh yes, they do, sir. Oh yes, all of these statements. The only thing that is in these statements is the actual capital put in at the beginning and those assets which are still in use. The only thing we have eliminated is the assets that have gone out, the outstanding example being the 6 inch loop. Apart from that item, all of the capital of this Company, all the capital it has invested is included in our rate base. We show the net figure because the depreciation has been taken away from us. We might quite readily show you, Sir, the gross figure less the amount of depreciation, and that gross figure would represent the actual investment at cost of the Company in all of the assets which are still presently used and useful.

Q I thihk what was in the Chairman's mind when he put it to you, and what was in my mind was that we are getting a figure, including the original amount of money spent when this Company put up that pipe line

in 1926?

A Yes, in 1926.

Q And know the capital put in each year from then on?

A That is right.

Q Written down by depreciation until you bring it to the first figure you gave us there in 1933?

A Yes.

Q And all the way through?

A Yes, all the way through from there. That is what the figure adtually represented. We can come to some net figure. That is a gross figure less a certain amount of depreciation.

Q Now these figures do represent the total investment of the Company year by year?

A Accumulated during the years at that figure less the amount of depreciation that has been taken off, and the gross figure which is represented there should be exactly what you have just stated, that it is the total amount invested by the Company year by year, only excluding those assets that are not now in use.

Q I see.

Q MR. FRAWLEY: Mr. Morrison, I think you have said everything in your remarks that I intended to bring out from you. I want to know perhaps this, you say that this is a problem, you regard this as a problem and one not too easy to reconcile, that is turning one's back on the excess profits of the Company and in the language of the man on the street, permitting them to amortize an investment which has already been gotten back?

A Yes. I quite appreciate the great difficulty which one finds in coming to that conclusion.

Q Have you made any examination of that, and have you anything that you would like to call the attention of the Commission to in the writings of accountants or others?

A Well I have a text here which deals with Public Utilities valuations, and which gives the various viewpoints of whether it is proper to use the original cost or reproduction cost, and different methods of arriving at accrued depreciation, and this problem that Mr. Lipsett has just brought forward, that of allowing the Company to get back again a portion or all of that money that it would appear they had already got out from previous profits.

Q Having in mind everything the Chairman gave you a moment ago, the only value of the text is insofar as you accept what views the author propounds.

A That is true, together with the fact that our firm has used this same principle in another rate too.

Q Which indicates that you accept the view that you are submitting to this Commission now?

A Yes.

Q I want to add to that if I can, the views of the author of that text, if you accept his views, do you find authority in that text for the submission which you are making to this Commission that they should do as your report indicates you have done?

A In that regard the author of this book puts forward all the different methods, amongst which is the one

that we think is the fair and correct method to be used.

Q Does he come out with the view and the opinion, that is a proper method?

A I think in most cases he merely gives both sides of the argument. I am certainly of the opinion that the method to be used is the original cost to the Company of the assets which are used and useful and that in arriving at the depreciation it should be based on the estimated lifetime of the assets brought up to date.

THE CHAIRMAN: I suggest you put that in. You have no objection to it going in?

MR. NOLAN: No, I have no objection, my Lord. It might be of some assistance to the Commission. It is not strictly evidence, but I am not taking any objection.

TEXT BOOK IN QUESTION IS NOW MARKED EXHIBIT "103".

THE CHAIRMAN: Apparently there are some other pages in Exhibit "102", the witness wishes this Commission to look at. We are at the moment limited to Pages 249 to 253. The withess has since made reference to other parts of the text. There is no objection we will make the whole of the book an exhibit?

MR. NOLAN: I have no objection.

MR. COMMISSIONER LIPSETT. Are you having any pages in this text marked?

Q MR. FRAWLEY: Yes. What is this? Well I will read it. It is "Public Utility Valuation, Reproduction Cost as a Basis for Depreciation and Rate

Base Determination by Willard J. Graham, Assistant Professor of Accounting, University of Chicago, 1934." Have you got any pages, have you got any chapters or parts you would like to call to the Commission's attention?

A In this particular book there are many - it deals in different chapters with many of the subjects that we have been dealing with here. One in particular is Rate Base Determination, which is covered by Chapter 1. That sets forth the different methods of determining the Rate Base. That is whether it should be by original cost or by reproduction cost.

Q Yes?

A The other chapter is Chapter 6, on the Accrued Depreciation, and Chapter 7 on the Basis of Depreciation. These are the main chapters which I would like to put forward.

Q Have you got still one more authority you want to put in?

A No, I think that is all.

....

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. NOLAN.

Q Mr. Morrison, a few moments ago you were discussing with Mr. Frawley the rate which had been allowed the Calgary Gas Company, 8½%?

A Yes.

Q That rate baving been approved, as I understand it, by the Board of Public Utility Commissioners?

A Yes.

Q You would not suggest, Mr. Morrison, that the hazard

of the undertaking in a gas company such as the Calgary Gas Company, was comparable to that of this pipe line, would you?

A I think they are comparable in my opinion.

Q You know there are vast reserves of gas in this Valley?

A I do not know. I am only going on what evidence has been given in that respect.

Q Do you know what the evidence was as to the probable reserves of gas which supported the order of the Board of Public Utility Commissioners in the Gas case?

A No, I do not know that.

Q You have not gone into that?

A No.

Q When you say they are similar, you were referring to the fact that this company was allied to another company and that had to do with the marketing of this product?

A That is one other factor.

Q You realize, of course, that the Gas Company, we call it the Calgary Gas Company, but it is the Canadian Western Natural Gas, Light, Heat and Power Company, Limited?

A Correct.

Q Enjoy an exclusive franchise in this city?

A I do not know that it does enjoy a franchise.

Q You do not know whether it is exclusive or not?

A I do not know that they even have a franchise.

Q Oh, you do not know that they have a franchise? Well you do know this, that they do not have large capital expenditures each year, such as have to be

[illegible]

[illegible] company [illegible] as that of this [illegible]

I think they are comparable in [illegible].

You [illegible] vast acreage of gas in this Valley?

I do not know, I am only going on [illegible] evidence has been given in that respect.

Do you know that the evidence was [illegible] the probable reserves of gas which supported the [illegible] of the Board of Public Utility Commissioners in the [illegible] case?

No, I do not know that.

You have not [illegible] into that?

[illegible]

[illegible] they [illegible], you [illegible] referring to [illegible] that this property was [illegible] company and they had to do with the [illegible] of this property?

There is one other factor.

You realize, of course, that the [illegible] company, [illegible] is the [illegible] Gas Company, [illegible] it is the [illegible] [illegible] Natural Gas, Light, Heat and Power Company [illegible]?

[illegible]

[illegible]

[illegible] do not know [illegible]

[illegible] do not know [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

undertaken by this Pipe Line Company?

A Well, they had during their initial stages.

Q I know, but since....

A Since then they have had no occasion to extend their lines to any extent.

Q Yes, and so far as the market is concerned, the market is the City of Calgary, is it not?

A In the main.

Q In the main it is the City of Calgary?

A Yes.

Q And when you say there is a similarity of security in the two concerns, what do you mean by that?

A Well, that in the present situation you have a commodity being supplied from Turner Valley, evidence of which has been given.

Q Yes?

A Then you have the market which is necessary for the disposition of that commodity?

Q Yes?

A The part we are interested in comes in between.

Q All right. You are giving it as your view that the hazard of the Calgary Gas Company is comparable to the hazard of this Pipe Line Division?

A To the extent of making a suggestion as to what the rate of return should be.

Q In these rates of return you have referred to in Exhibit "102" at Pages 249 to 253 inclusive, there is no reference made in any of the cases cited there to a pipe line operation?

A No, that is correct.

Q These deal exclusively with light and water and

gas and telephone?

A That is correct.

Q To what you and I understand as Public Utilities in the ordinary sense of the word?

A That is right.

Q And as I say to you again, there is no reference there to any pipe line rate case?

A No. I think I made that clear in giving my presentation.

Q Yes, I was not sure whether it was clear or not. Now, Mr. Morrison, you have had access to the books of this Royalite Oil Company?

A Yes.

Q And perhaps you have been present in Court when something has been said about faulty bookkeeping. You agree that these books of this Company are properly kept?

A Oh yes.

Q And well kept?

A Yes. I suggested to Dr. Boatright that he should probably correct that impression.

Q But you, Mr. Morrison, have firsthand knowledge of the method and system of bookkeeping of this Company?

A Yes.

Q And you have no criticism to offer of the manner in which the books are kept?

A As a Company as a whole, no. Not divided, of course, into departments.

Q Not dividing it into departments. You know in your experience as an accountant of companies that have various departments of operation, where the books are not so set up that at a glance you can tell what the

actual costs are in respect to each department.

A Oh yes. It is quite usual to find many many companies that make no attempt whatever to distribute their operations into departments.

Q And why do they not attempt that, Mr. Morrison?

A Well it is quite - they must have a fairly elaborate cost accounting system in order to do that. Many of them feel that the cost involved is not necessary because they do not require that information for any particular purpose.

Q Yes, and they have, of course, to make a report to the shareholders at the end of the year, and that is the Balance Sheet of the Company?

A The Company as a whole.

Q Which can be made up without going into the difficult accounting that you and Mr. Taylor have had to go into?

A That is correct.

Q It is not fair to the Company to leave any impression that there is any fault to be found with the way they have been doing it in the past?

A Oh no. At least I hope I have not made any such suggestion.

Q No, you have not. But it would be unfair if anyone did leave such an impression?

A Yes, I think it would.

Q Now Mr. Morrison, will you tell me in a word, if you will, please, without going into your accounts, and without going into Mr. Taylor's accounts, what are the main points of difference between you? As I understand it the matter of totals is unimportant?

[illegible]

[illegible] request [illegible]

4 [illegible] It is quite much [illegible]

[illegible]

[illegible]

2 And [illegible] they [illegible]

4 [illegible] they [illegible]

[illegible] system [illegible]

[illegible] that the [illegible] necessary

because they do not [illegible] for any

[illegible].

[illegible] the [illegible] report [illegible]

the shareholders [illegible] and that

is the Balance Sheet [illegible]

4 [illegible]

[illegible] into the [illegible]

[illegible]

[illegible] correct.

In [illegible] to the Company [illegible]

[illegible] with [illegible]

the [illegible]

[illegible] much

[illegible]

[illegible]

[illegible]

[illegible]

[illegible] if [illegible]

[illegible] and

[illegible]

[illegible]

[illegible]

A So far as.......

Q So far as the operating costs, direct or indirect.

A Well of course it is important that we agree. But I understand that insofar as, speaking of the period for 1938, that insofar as the total expenses to direct costs are concerned, that we are in agreement with the exception of the storage.

Q Yes.

A At the East Calgary tanks.

Q Yes.

A With regard to the direct costs, I understand that the figures we have presented, Mr. Taylor agrees with in toto.

Q Yes?

A Insofar as the indirect expenses are concerned, there is only one difficulty of the storage.

Q Yes?

A The indirect expense is a matter of the basis of distributing those indirect expenses.

Q Your first point, if I may put it to you, is that we do not agree upon the basis upon which the indirect cost should be distributed?

A That is correct.

Q Indirect costs?

A Indirect costs, including administration expenses as an indirect cost.

Q And as to the distribution of direct costs?

A We are in agreement as those are distributed by the Company.

Q And no question may arise as between the accountants on that?

A We have accepted the distribution. I want to make that quite clear. We have not questioned the distribution of direct costs.

Q But when we get to this item of indirect costs, including as they do administration expenses as you say?

A Yes.

Q There is a difference of opinion as to the basis upon which these indirect costs shall be distributed?

A That is correct.

Q That is point 1, is it, Mr. Morrison?

A That is so, Sir, yes.

Q What is the next point upon which we differ?

A I think probably the next point would come under the head of first the Rate base itself. That is to say the amount of money which is presently invested by the company.

Q All right. That is given by you for the nine months' period ending September 30th, 1938, at a figure of $897,498.97?

A That is the net figure, Mr. Nolan. It must be remembered that figure will vary with each different basis of depreciation. That is not the gross amount. That is the net figure.

Q No, that is the net figure?

A Yes.

Q Is it not, just in a word, that your method of dealing with the capital investment is different from Mr. Taylor's?

A Yes. Of course there have been three methods now suggested.

Q We will forget Mr. Hill for the moment. But so

far as you and Mr. Taylor are concerned, it is just a question of the treatment of the capital investment?

A To a certain portion of the capital investment.

(Go to Page 2654).

Q How do you treat it and what is the difference between your treatment and Mr. Taylor's?

A Well we have taken the books of the company and have shown in our rate base, that the total expenditures made by the company on all the assets that are presently used and useful; in other words we would ignore any assets which may have been purchased and which prior to the date of our examination has gone out of the system. I would, I am of the opinion that that is our main difference. I think in all matters we are practically in agreement.

Q Yes, might I describe their method as being a method which takes into account cash money put into the business less the cash money taken out?

A Yes, and no; the first part I will agree with.

Q The cash money put in?

A The cash money put in.

Q We will leave it at that, that is what the Price,Waterhouse figures mean?

A No, you must take the other matter, you say the cash taken out, I say that comes down to Major Lipsett's view point, that is the cash taken out was credited directly to the capital but it does not affect the cash taken out.

Q But there is this second difference between you in the way you set up the capital investment in this company, you and Mr. Taylor, you differ in your opinion as to that?

A Yes.

Q That is point No. 2?

A Yes.

Q Now is there a third?

A Then of course the basis of depreciation.

Q Yes?

A Mr. Taylor has used, when I say "Mr. Taylor", the Price,Water-

house Company, the company's auditors.

Q The Price,Waterhouse Company?

A Yes, they use a figure of a 10-year life from 1936 I think.

Q Yes.

A We have used varying life-times. Now insofar as differnt lifetimes, we would arrive at a different result.

Q Quite so.

A We are not suggesting at the moment which basis is the correct one because our submission is that the estimated lifetime of the field, whatever that may be, is the correct basis for depreciation.

Q Yes.

A Now then there is a difference there and I think that probably is all because the Price,Waterhouse Company did not prepare any statement showing the rate of return other than to recommend in the report that in their opinion 20% was a fair rate of return.

Q Yes. Now turning for a moment to what I call your "labour ratio basis" Mr. Morrison?

A Yes.

Q Let me see if I understand that, you say that the number of men employed by the Royalite Oil Company in the pipeline department either on capital expenditure or in operation as compared to the total number of men employed by the Royalite Oil Company either on capital expenditures or on operations gives you the rate which you have applied to this distribution of indirect costs?

A That is correct.

Q And it works out according to your computations, Mr. Morrison, for the last period ended September 30, 1938 at 18. something percent?

A That is correct.

Q At about 18%?

A Yes.

Q Does that mean I take it that 18% of all the men employed by the Royalite Oil Company on capital expenditures or on operations, are in the pipeline department?

A That is right, you see their services are benefitting the pipeline department.

Q Yes, now when you take that labour ratio basis of yours, you are using your own judgement and your own experience, to determine that ratio, are you not?

A Oh no, we take the books of the company, tho payrolls of the company.

Q You take the payrolls of the company?

A Yes.

Q But what I am trying to get at is this, there is no hard and fast rule in your profession as to how indirect costs should be distributed?

A Oh no, there are many methods of distributing indirect costs.

Q And you have taken the ratio as between those in the pipeline department as opposed to those in the whole employ of the company?

A As compared with---

Q As compared with those employed by the company?

A By the company, that is right, because we feel that is the fair and equitable way to do it.

Q Yes, and that, Mr. Morrison, and I say it with great respect, is your opinion in the matter?

A That is correct.

Q And you may be wrong about that, you do not think so but you may be?

A

A May be wrong in what regard?

Q May be wrong in using that ratio?

A Well until I have been shown some better method I am certainly going to stay with that one.

Q Yes, I have no doubt you are. Now what is the other method which might be used?

A Well there are different methods which might be used but I would not subscribe to them.

Q No, but tell me what they are.

A There is the method of using the revenue of the company.

Q Yes.

A Comparing the total revenue taken by the pipeline department as compared to the total revenue of the company and the basis of indirect costs would be made on that distribution.

Q See if I understand that, it would be that proportion of the total revenue of the company contributed by the pipeline department?

A Compared with---

Q Compared with the total revenue of all departments?

A That is right.

Q That is what is known as the revenue basis?

A That is what is usually referred to as the revenue basis of distribution.

Q Yes. Now for my own information, Mr. Morrison, is there another method?

A Oh yes, there is the method of taking, not the labour ratio method, but there is the method of only taking those men employed in the operating department; in other words operating labour as distinct from capital labour; in other words we eliminate the capital labour altogether.

Q Let me go back again, and correct me when I am wrong, first let me put the revenue basis, that is the one method?

A Yes.

Q Then there is the labour ratio basis which may be divided into two parts or into two kinds.

A At least two.

Q At least two?

A Yes.

Q One, all of the men employed in the pipeline department?

A Yes.

Q As compared with all of the men employed in the whole company?

A That is right.

Q That is one kind?

A Yes.

Q The second kind of labour ratio method would be the number of men employed in operations in the pipeline department as compared to the total number of men employed in operations by the whole company?

A Yes, and by operations we mean non-capital items.

Q By the operations we mean non-capital items?

A Yes.

Q Now is there another kind of labour ratio basis?

A It might not be another kind of labour ratio basis but it might be another method of arriving at either of those methods, in other words we might just take the number of men without regard to the value of their wages.

Q Yes.

A Or we could take the hours they work, we could reduce it to an hourly basis or we could reduce it to a money consideration?

Q Which you have done?

A Which we have done in the first method which you have suggested.

Q Yes, which is your method?

A Which is the method we suggest.

Q In that method which you have used you have reduced the men to a money basis?

A Yes.

Q The reason I know you did that is because you took only 5/7ths of the drilling men's wages?

A That is correct.

Q To try and bring that back---

A To a parity with the others.

Q So it is money we are talking about?

A Yes.

Q So for the sake of the method which you use where you get your 18%, it is the proportion of men against other men?

A Very true, bringing these men to an equal parity so that the comparison is a proper one.

Q And those methods, and may I call them, three methods?

A Yes, for simplication I think you can.

Q I can call it 1, 2A and 2B if you like?

A If you call it the revenue basis and the labour basis and the operating labour basis .

Q All right, the revenue basis, the labour basis which is yours?

A Yes.

Q And the operating labour basis which is Mr. Taylor's?

A Yes.

Q Those three methods have been applied in your experience to problems of this kind?

A Oh yes, yes.

Q You have applied them yourself on other occasions?

A It is quite possible.

Q And you felt that you were right in using these others methods

at the time you used them?

A Well of course the circumstances of each case will have to be the governing factor.

Q Yes, but there is nothing wrong in the methods themselves, one as opposed to the other?

A Well nothing, there is nothing wrong with the method.

Q Nothing inherently wrong?

A No, no.

Q No, it is a matter of the opinion of the accountants as to what method fits in to the particular case under consideration?

A That is right, to the particular case under consideration.

Q And that is a matter based on his judgment and his experience?

A And the circumstances of the case under consideration.

Q Yes, but having found the circumstances of the case under consideration, as to what methods shall be applied, he uses his own best judgement?

A Oh naturally.

Q Yes. Now it is very important, is it not, in this case as to what kind of labour ratio basis we take?

A Well it would appear to be. I had not thought when I took, developed this labour ratio which I have used that it would make any material difference. Apparently it has.

Q It makes a difference of 10%?

A Approximately 10%. Of course the method adopted in Exhibit "101" divides it into, Exhibit "100" I should say, divides it into two sections, but it would appear that there is approximately a difference of 10%.

Q Yes, the point I am trying to make, Mr. Morrison, is that if a ratio basis is to be fixed for this company, it is important that we get the best method because the answer you cam

get on the use of the two methods is very very widely different?

A Yes, yes, I quite agree with that.

Q So that is something to which all our minds will have to be directed?

A That is true.

Q Now when you spoke a few moments ago about tank rentals, that is part of the direct costs?

A That is part of the direct costs.

Q When you were asked about that the other day, Mr. Morrison, you said at page 2,125, I am talking about tank rentals.

A Yes, the East Calgary tanks.

Q The East Calgary tanks; you say from an accounting point of view, at page 2125, Mr. Morrison, perhaps you have not got it?

A No, I have not, but I can follow you.

Q "From the accounting point of view I dealt with the actual situation which we have here. If we have of course a situation where there were many customers then I would have considered that situation also."

A Yes.

Q And I just give you the other statement on the other page, on page 2126, the question "Q. But the effect of your evidence then I take it to be, as an chartered accountant, you would have eliminated these anyway. A. Yes, that is correct, under the present circumstances."

A Quite.

Q Now see if I am putting this fairly to you, Mr. Morrison, you say that the present circumstances and things as they are, there are three customers, the Imperial Oil, the B. A. and the Lion?

A That is correct.

Q And things being as they are, you eliminate that storage rental from your computation?

A That is true.

Q But you are qualifying that remark by limiting it to the present circumstances?

A Oh yes, I am only dealing, I am not dealing with the future at any time in my report, I am dealing with the present situation.

Q Yes. But now when we come to a consideration of Mr. Hill's evidence, and what you have just said reminds me of it, he is dealing exclusively with the future?

A Well not in respect of this particular thing.

(Go the page 2663)

Q No, but in respect of his investment and the manner in which he treats it, he is looking to the future?

A It would appear that that is so.

Q And is it equally true to say that your efforts and Mr. Taylor's efforts as shown in your reports and the accompanying statements is what has gone by in this company's history?

A That is true.

Q It is the past?

A Oh, yes.

Q And from your examination of these rate cases, and I take it you have looked at some of them, you agree with me that the reproduction cost method, the revaluation theory, is used in very many cases to determine the rate base?

A Well, I don't know in very many cases, it is used.

Q Was it used in the Gas Company?

A No.

Q That is the only case you had any personal experience of?

A Personal experience of, yes.

Q But the difference between what you have been doing, and Mr. Taylor on the one hand, and what Mr. Hill does on the other, is the accountant looks back and Mr. Hill looks forward?

A Well, of course, he was commencing by looking at the present time, by taking an actual appraisal of the property,

Q To-day?

A To-day.

Q Its physical worth?

A Yes.

Q And during the course of his examination Dr. Boatright pointed out to him that there was very little differnnce,

just wait, I think I can get the figure for you, that there was very little difference between the figure at which he had arrived and your figures?

A Well, of course, I know that Dr. Boatright made that suggestion.

Q Giving as your figure, Mr. Morrison, if I might interrupt you, $1,611,000.00?

A That is the book figures, as at the 30th of September, 1938.

Q Yes, and Mr. Hill's reproduction cost figure of $1,619,226.00?

A Yes, but the difficulty with that comparison is that Mr. Hill put the difference between the one million, five hundred and some odd thousand and the one million seven, as being either one of two things, namely, the value as a going concern at one time or to include the value of the utilities at another.

Q Yes?

A Now, I am not sure which it is supposed to represent. If it represents the value of the utilities then, of course, our figures are fairly close.

Q Yes, and close to a few thousand dollars?

A Well, they total, as we show it, $1,611,000.00.

Q MR. FRAWLEY: And what does Mr. Hill show?

A Mr. Hill shows, I have not his report.

Q MR. NOLAN: If I have the notes properly down, it is $1,619,226.00?

A One million, yes, that is the new gross value, $1,619,226.00, as shown on page 12 of Exhibit "96".

Q And to clear it in my mind, Mr. Morrison, what amount have you included each year for working capital?

A A proportion of the inventory of materials on hand at the end of each year.

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Q A proportion of what?

A Of the materials on hand at the end of each year. To illustrate, at the 30th of September the total inventory of materials was $544,224.00, which is shown on page 23.

Q Let me find that?

A On our report.

Q Would you mind giving me that again?

A On page 23, inventory of materials, $544,224.00. Then we take a proportion of that, namely, 18.29%, which will give you approximately $100,000.00.

Q Yes, and you do that throughout the period?

A Throughout; on the basis of our distribution, that is involved with the matter of the distribution of the indirect costs.

Q Then what have you done each year with the utilities, Mr. Morrison?

A We have distributed those in the same relationship, that is to say, the total amount of indirect costs which were distributed we distributed the smaller amount of the utility assets to the pipeline department, which in the year 1938 would be 18% as against 28% on your method, the method of the Price-Waterhouse.

Q Yes. Now, that figure of 18%, Mr. Morrison, is not the same in each year, of course?

A No, no.

Q Will you just draw my attention to the statement which shows how the 18% varies from year to year?

A Well, it will be shown on different statements.

Q It is all gathered on one?

A It is all gathered on one, I think, no, I doubt if it is, Mr. Nolan. I think we will have to refer to each individual

sheet commencing with statement No. 10, statement No. 11 rather, statement No. 11.

Q Now, just let me look at those two, statement No. 11?

A Yes, I have that. and we have to go through them, do we?

A I would think so. I do not think they are summarized.

Q Let me see, I made a note when you were giving evidence, Mr. Morrison, and, perhaps, I can check you up, 1934, 7.94142%?

A That is correct.

Q 1935, 4.25365%?

A That is correct.

Q 1936, 8.288807%?

A 8.28807%.

Q 1937, 14.18656%?

A That is correct.

Q And for the nine months' period of 1938, 18.290267%?

A No, 18.29067%, that is correct, sir.

Q So, generally speaking, and forgetting all of these decimal places, the manner of distribution adopted by you was 7% in 1934?

A Yes.

Q 4% in 1935?

A That is right.

Q 8% in 1936, 14% in 1937 and 18% in 1938?

A That is correct.

Q Now, why does that figure fluctuate so greatly?

A Because of the fluctuation of the labour in those years.

Q Because of the capital expenditures incurred in those years?

A To some extent.

Q Well, that would follow, would it not?

A It would follow that that would be one of the reasons. It would naturally follow that if there is more work being done

for some other department, that that department would bear a higher proportion of the indirect costs.

Q Yes. So that in a year where we have a large capital expenditure?

A Yes.

Q The department in which that expenditure is being incurred will bear a larger proportion of the indirect costs than in a year where there are less capital expenditures in that department?

A That is correct.

Q And that, you say, is the reason for the fluctuation in these figures?

A As, yes, that is the reason for the fluctuation, at least that would be one of the reasons, and, perhaps, the main one, because I presume that the operating labour would run fairly close although you can see what the result would be by comparing the Price-Waterhouse statements, which in 1937, shows 10.3912% and in 1938 shows 28 some odd per cent.

Q Yes, you have that statement before you, have you not?

A Yes.

Q I wonder if it would be much trouble for you to compare for me, beginning with the year 1934?

A Yes.

Q Their percentage of distribution with your own?

A Surely.

Q In 1934?

A In 1934 there are two figures shown, the first distribution of 6.38534%, on a certain figure......

Q Yes?

A And 10.9094% on a different figure.

Q Yes, they break theirs down once more, don't they?

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6a

A Apparently.

Q They take an extra step?

A Yes.

Q Perhaps it would not be convenient to compare those when you have those two figures?

A Well, I have not got any further comparison.

Q Well, we will have to do that in our own way?

A Yes.

Q Now, it has been mentioned in evidence, Mr. Morrison, but not proven yet, that there will be an expensive budget for the year 1939?

A Yes.

Q In the pipeline department, and the figure mentioned was $263,000.00?

A For......

Q For 1939, this year?

A Yes, but what is that for?

Q That is for capital expenditures in connection with the pipeline?

A Capital expenditures?

Q Yes?

A Yes.

Q Now, under your system of amortizing those figures, what do you do with the capital additions in 1938?

A We add them to the rate base.

Q All of that?

A No, 50% of them.

Q Half of what is in 1938?

A That is correct.

Q Then the expenditures were large or small in 1938, the capital expenditures?

A Well, they were fairly large, they completed that 6-inch line.

Q Yes, and then in 1939 you again take half of the capital expenditures for that year?

A For the purposes of amortization.

Q Yes?

A Yes, I think that is the recognized practice in order to ascertain the rate, is to take half, in order to give the earnings and the depreciation.

Q So that for the year 1939 they would be much greater than for the year 1938?

A Just how do you mean?

Q Taking half of 1938, which was large, and half of 1939, which is going to be large also?

A Yes.

Q You would have a larger figure for 1939 as compared to 1938?

A Yes, added to the rate base.

Q Yes?

A Oh, yes, and that, of course, would get its proper recognition in the rate base by amortization, which would be a charge against earnings and its rate of return.....

Q Yes?

A The fact that they are making capital expenditures does not detract from the method which we have adopted in recognizing those expenditures to the company, they are added to the rate base.

Q Now, reverting back, Mr. Morrison, to the dip in your percentages?

A Dip?

Q Well, I will call it a "dip", it is from 8% in 1934 to 4% in 1935?

A Yes, a dip.

Q As a matter of fact, it is 7.9% in 1934.......

A To four something.

Q To 4.25% in 1935?

A That is correct.

Q And that goes down because of the capital expenditures of that year?

A Yes, that year I think they built the absorption plants and that department would take a greater portion of the indirect expenses than it did in the previous years.

Q And what does the absorption plant have to do with the pipeline department?

A What has it to do with it?

Q Yes, the answer is "Nothing", is it not?

A Oh, no, they are all inter-related.

Q You do not call the absorption plant a part of the pipeline operation, do you?

A No, but I claim that a portion of the expenses, the administration expenses of this company should go to the absorption plant.

Q All right, and it is because in 1935 that they built the absorption plant?

A Yes.

Q That we find your percentage dropping from 7.94 to 4.25?

A That is one of the reasons.

Q That is one of the reasons?

A And an important reason.

Q An important reason?

A Yes.

Q So whenever there is a large capital expenditure in some other department of this company?

A Yes.

Q Your percentage of distribution of the indirect costs to this pipeline department will go down?

A Not necessarily, you might have the very opposite effect, if the capital expenditures happen to be in the pipeline department, the ratio would go up.

Q Let us assume it is not in the pipeline department?

A Then it would go down.

Q So then I may put it to you this way, that when in any year there is a large capital expenditure in a department other than the pipeline department?

A Yes.

Q Your percentage of distribution of indirect costs will go down in that year?

A That is correct.

(Page 2672 follows.)

Q So that one might expect to find a great fluctuation on the percentage which is used from year to year?

A It would in this type of business where you have a company who are from year to year going into large capital expenditures. I think is the reasonable thing to be expected. I think it proper that a reflex of the distribution of administration expenses should be made on that basis.

Q You say that the fluctuation is the reason for adopting the method which you have used?

A Not the reason for adopting it. The reason for adopting it is that this company is composed that it has capital expenditures going on concurrently with operating expenses, and therefore is not getting a fair distribution of the administration and indirect expenses, and that I am quite of the opinion that this is a fairer and a correcter method.

Q What it amounts to is this, Mr. Morrison, in your opinion that when you have a large capital expenditure in another department?

A Yes.

Q More of the men's time is being used in the department than in the pipe line?

A Yes.

Q Than when there are not these large capital expenditures?

A That is the theory.

Q So that the indirect and the operating costs at that period of the pipe line department will go down.

A If the capital expenditure is in some other department that is correct.

Q Now there were capital expenditures in the year 1938

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in the Pipe Line Department were there not?

A Yes.

Q And we have a figure of 18.29%

A Yes.

Q If there had been no capital expenditures in the Pipe Line Department in the year 1938, what figure would you have obtained, what percentage?

A I do not know. It would all depend on what the payrolls showed. These figures are the result of an actual calculation of the payrolls, and if conditions had been different you would have had a different figure.

Q You can tell me this, at least, whether your percentage would have gone up or gone down if there had been no capital expenditures going on in the Pipe Line Department.

A But what about the other departments? Would there have been any there? If you make a different condition in one, are you assuming then that the conditions in all other departments are the same?

Q Assuming they were all the same as they were, in fact, in 1938. You know what they were in 1938?

A Yes, 18%.

Q Yes? Some of that was in the Pipe Line Department, some of that capital expenditure.

A When I say 18% I mean that was the proportion of labour ratio in 1938 which included capital expenditures in the Pipe Line Department.

Q Then can you tell me, assuming that everything remained the same in the other departments, and there had not been any capital expenditure in the Pipe Line Department, what would happen to your 18%?

A It probably would have gone down. But if you create a different set of conditions you have to make a new calculation.

Q But I wanted to find out what the figure would be if there had been no capital expenditure in the pipe line department?

A I think it would have gone down.

Q I think so too. As I understand it, Mr. Morrison, the basis which you have taken, is a man basis, translated into payroll?

A Right.

Q That instead of using man hours you use dollars and cents?

A Yes.

Q But this much is clear, that the men who are in the Pipe Line Department, working in that department, is one part of your equation, you see what I mean?

A Yes.

Q Are not all engaged in operations?

A Some. Some were capital, such as the six inch line. Surely.

Q Have you any figures showing what the percentages are?

A No. The Company will have them.

Q You have not done anything with a view to breaking that down to see what pipe line men were on capital expenditures, and what pipe line men were on operations?

A No. We have done it on the basis of all men, whether they were engaged in capital expenditure or maintenance work.

Q So that when we look at Statement 21?

A Yes.

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Q We are dealing with the figure - $42,922.76?
A Yes.
Q And that figure, Mr. Morrison, is 18.29067% of $112,968.27, plus $121,702.01?
A That is correct.
Q And that is all charged to operating?
A That is the proportion of the indirect expenses and administration which we have allocated to the Pipe Line Division for that period.
Q Are you in a position to agree with me, Mr. Morrison, that the percentage of men in the Pipe Line Department engaged on capital expenditure, as a basis of these operations has a relation of 60 to 40?
A Well I have not checked the figure, Mr. Nolan. No doubt the information given to you is correct. I have not checked the figures.
Q All right, thank you very much.
Q MR. FRAWLEY: Mr. Morrison, so that I will understand you, and the examination that Mr. Nolan has just been having of you, the Price, Waterhouse people have used a labour ratio basis which is a qualifiaction of your labour ratio basis?
A Well it is another method of distribution.
Q On a labour ratio basis?
A On a labour ratio basis.
Q They have eliminated what they call capital labour?
A That is correct.
Q Now, take a concrete case, because I find I am able to understand it anyway better when it is concrete, these are only the indirect costs you are bothered with distributing?,

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A Yes, indirect. And when I speak of indirect I include two items, the proportion of the utility expenses and the administration charges under a composite heading of Indirect Expenses.

Q Taking administrative expenses, that is readily defined as being the Head Office salaries?

A Yes.

Q Calgary Office salaries and even some of the Toronto Office salaries?

A Well there is Toronto Office expense.

Q That is a proportion - it is down pretty fine at that stage, but it really means some small proportion of the Executive Officers' salaries?

A We were unable to get the details.

Q Mr. Burns was going to look into it and give us the details of that item?

A Speaking of the first two items shown on Statement 22.

Q Which are the biggest in that department on Statement 22?

A Yes.

Q which is salaries Administrative officers, $20,438.35, and Employees' administrative offices $21,648.97.

A Yes.

Q Add those together and you get something well over $40,000.00?

A Yes.

Q Which alone is half of the total item for the period in 1938?

A Yes.

Q That means that what you are seeking to do is distribute a fair amount of those administratiive officers'

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salaries?

A That is correct.

Q Can we again, at the expense of labouring that take Mr. John McLeod's salary? That is a typical instance of the problem we have to solve?

A Yes sir.

Q Do I understand what you say is that in the year in which there was the absorption plant being built, Mr. McLeod was spending a great deal of time on that part of the Company's business?

A There is no doubt he was, that is to a greater degree that he would otherwise be doing.

Q In other words, you say it is to be supposed that during the year 1935 Mr. McLeod was concerned with examining the plans of this plant before it was built; discussing it with the engineers; and during the construction he probably visited the plant from time to time and was generally concerned considerably with the construction of that absorption plant?

A Yes.

Q And that is why you allocate to the absorption department p at least take away from the Pipe Line Department,

A Take away from the Pipe Line Department.

Q More of Mr. McLeod's salary than you would in the year 1938 when the very opposite is happening, and Mr. McLeod is building a pipe line?

A That is right. That puts it, I think, fairly clearly.

Q And that is the essential difference between you and Mr. Taylor's people? Do they say that any portion of Mr. McLeod's salary should be charged to the Pipe Line Department during the year in which they are building

[illegible]

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the new line?

A Oh no. There would be the proportion which the operating men of that Department would bear to the total operating men. Just to further illustrate that situation. The drilling of wells probably comes into it more clearly than anything else, in that that is all capital expenditure. Now no portion of Mr. McLeod's salary, which is included under Administrative Officers, will, under the labour ratio method used by Price, Waterhouse & Company be charged to the drilling of wells.

Q I find that difficult to understand. Let us have first the facts or what you assume to be the facts.

A Because there are no what we call maintenance men. The drilling of wells is all capital expenditure.

Q Yes.

A Because of that fact these men who are employed in the drilling of wells would be excluded from their calculations. Whereas we have included them.

Q In the result then, no portion of Mr. McLeod's salary was distributed into the drilling of wells department?

A It is under our classification but not under theirs.

Q Yes?

A Because there are no operating men as such, and the distinction between operating men and capital labour is that one is a charge against operations, against the revenue of the company.

Q I am doing this for the purposes of making it clear to the Commissioners, and also clear to myself. If the fact is, suppose we walk into Mr. McLeod's office

and found that during these periods he was engrossed in the work of the Royalite Oil Company that has to do with the drilling of wells?

A Yes.

Q Conferring with Mr. Burns about it, and with Mr. Heard, and the other executive officers of the Company. If we knew that to be the fact. What is the justification of an accountant for not including any portionof Mr. McLeod's salary for that month, amounting whatever it might have been, two or three days, what is the justification for no portion of that salary being charged to the drilling of wells department.

A Well, while I do not pretend to speak for the Company, I am merely keeping up what they say in their report, which is Exhibit "100" at the bottom of page 2, "In this connection it should be mentioned that in making the distribution just referred to the payrolls applicable to capital additions have been excluded, as in our experience it is not the general practice for companies which are in operation to capitalize charges of this nature." I may explain that here you have a company here who are drilling wells, but at the same time there are operating expenses continuing and which would continue whether they were drilling wells or not. Now it is because of that factor it is suggested, that it is suggested that it is not proper or good practice, according to their experience to capitalize any amount of say Mr. McLeod's salary, because Mr. McLeod's salary would be paid to him whether there were any wells being drilled or not.

Q Not so much to capitalize but what I am concerned with

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is only the apportionment of Mr. McLeod's salary.

A That is the apportion. You distinguish apportionment of salary as against what is charged against operations, and by operations I mean against the revenue of the company as opposed to what amount will be capitalized and set up as an asset. In other words you drill a well. It costs you $100,000.00. No portion of Mr. McLeod's salary is in there. If there was an apportionment made that well might have cost $105,000.00, $5,000.00 being the portion of Mr. McLeod's salary. Instead of putting that in as a cost of the well, the Company, for their own reasons, say " No, we are not going to capitalize that, we are going to charge it against revenue. We are going to regard it as an expense." In other words, it did not cost the Company any more to drill that well because Mr. McLeod's services were available anyway. That I think is the answer. As against that, I am not suggesting that they should capitalize the amount, but for the purposes of this Commission we are endeavouring to allocate the expenses. I am not suggesting the Company should have capitalized this. But if they wish to capitalize it it is quite proper. In my opinion it is being done every day in the drilling of wells, in that some portion of administration is charged to capital. We are not suggesting that they should capitalize it. We are suggesting for the purposes of this Commission that a portion of those expenses should at least be distributed as belonging to the drilling of wells, and they might take it up in their Profit and Loss Account if they so desire. Nevertheless, we suggest that a portion of

Mr. McLeod's salary for the purpose of this Commission should be allocated to the drilling of wells.

Q You are concerned primarily with allocating a proper amount and no more, and no less to the Pipe Line Division, of Mr. McLeod's salary?

A That is right.

Q And in seeking that only a proper share of Mr. McLeod's salary is put upon the Pipe Line Division, you say that all of the other departments of the company, whose business Mr. McLeod manages, from day to day, should bear their proportion of his salary?

A That is correct.

Q Whether it is what you call a capital department or an operating department, still Mr. McLeod is, in fact, working for these departments and on their behalf?

A Surely.

Q You should not load up the Pipe Line Department with any more than that portion which represents his labour for the Pipe Line Division?

A That is true. If it were possible for Mr. McLeod, or any other officer, to have a time sheet, and show every day just what they had done, that would be the ideal method.

Q As a matter of fact that is what he does?

A Oh no.

Q There is no such record kept of it?

A No.

Q Is that not what he does. For instance this morning he is engaged with the Pipe Line people and this afternoon is the absorption plant people. Is it fair to say that that is the way in which his daily work is

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divided up?

A He is the General Manager of this Company.

Q That is matters of policy to be settled for the Pipe Line Department come before him just as matters dealing with the Absorption Plant?

A I do not know the routine of the office, but as General Manager I think that would be the routine.

Q I hope there is no question about that. He is the General Manager of the Company, and concerned with the operations of all departments?

A I would say so, because Mr. McLeod referred in our discussions about distribution about the building of the 6 inch new line, and because of that building his time was more occupied in the Pipe Line Department. I recognize that fact, and I endeavour to recognize it all the way through.

Q I recall that was one of Mr. McLeod's observations while you were having these controversial discussions leading up to......

A To the method of distribution.

Q Did you have some agreement with Price, Waterhouse people in connection with, the labour ratio distribution or was that just an agreement as to totals?

A Well it was not an agreement. We did agree in a sense, but not a binding agreement, and I am not suggesting it should be even so regarded. But in regard to the method of distribution, it was finally agreed we would use the method that we have adopted but the results were not satisfactory to the Company's representatives, and they decided to use another basis.

Q Perhaps we are talking about different things. Insofar

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as the amount is concerned we have an agreement.

A Oh yes, insofar as the accuracy of the figures which we have used and presented, and the percentages we have used, we have an agreement.

Q That is perhaps what I was referring to.

A Well then, Mr. Frawley, I am quite correct in saying we have an agreement on that basis.

Q Mr. Nolan was asking you whether or not you were limiting your submissions to the present, to existing facts. I think you said you were?

A Yes.

Q As against the testimony from other people looking to the future?

A Yes.

Q That perhaps should be explained. If a pipe line rate is fixed by this Commission it will, at least, last for some appreciable length of time. But even though it only lasted two or three days, at least it is looking to the future to some extent. What did you precisely mean when you say you confined yourself to existing conditions?

A That is to say that the results which I have given to the Commission are based on the actual experience of the Company and that experience can, for all practical purposes, be brought up to the 31st of December, 1938, because it was agreed that those were representative, the figures I submitted were representative of the year 1938. It does go one step further than that, in suggesting what a change of conditions may do.

Q What you mean is that you are telling to the Commission, and you have said in your Report, what it cost the Royalite Oil Company as of the 31st of December, 1938,

[illegible]

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to transport a barrel of oil from Turner Valley to Calgary?

A Yes.

Q You say that having arrived at that cost, that you add to that a rate of return on the investment and that becomes the rate per barrel which the Company should charge its customers?

A That cost, of course, including amortization?

Q Yes?

A Yes, that is correct.

Q That is why you are saying you are concerned with the present?

A With the present.

Q Without speculating on the future?

A Yes.

Q Which you say, as I understand, you will leave to be dealt with in the future if changed conditions distort the cost which you have laid down here?

A That is true.

Q Now my friend was discussing with you whether or not the hazards between the operation of this pipe line company and the operations of the Calgary Gas Company were in any way comparable. You said you thought there was a similarity of security. You discussed the market. Have you assumed in your calculations that the 5 years or 10 years or 15 years, 20 or 25 year periods, that those are the facts, that those lifetimes are facts?

A Oh absolutely. I am not suggesting these lifetimes are correct, but I am taking from the evidence that has been presented that these are facts.

Q When you say there is security, you are taking it on the

[illegible]

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fact that you take the 15 year period for instance, that there will be oil coming through the pipe line 15 years from now?

A Yes. Similarly with the markets. There is a market at the present time. I am dealing with that in precisely the same way. I am not suggesting that that market will continue. I am not competent to speak as to that.

Q You do not know, if all the experts are wrong and the Commission would accordingly be wrong when they accepted any evidence of the experts as to the life of the field, but if it should happen that in no time at all, in the matter of say ten months, that all of the oil in the Turner Valley would disappear, you then say that that would distort your figures and some other Board would have to change the rate which you submit, or your evidence leads up to?

A That is correct.

Q That is all, Mr. Morrison.

Q THE CHAIRMAN: I suppose one of your difficulties is that this Pipe Line Department is associated in its work with the other activities of this Company?

A Yes, that is a difficulty of distribution.

Q It would appear that if by chance this Company, this Pipe Line Department so-called, is to be the subject of Governmental regulations hereafter, it would be an advantage to have it severed from all other activities?

A Insofar as its records were concerned, oh yes, I think that would be very advisable, that the records of the Pipe Line Department should be kept separate and distinct from those of the other departments.

Q I am not quite clear there on the figures we have as to

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you whether or not this has been arrived at. Supposing you take a period, say any figure you life, say a period of 15 years?

A Yes sir.

Q As the life of the field, and suppose you adopted the view that the Company has adopted, that 10% depreciation was the proper depreciation to make, and which they are permitted to make by tbe Dominion Government for Income Tax purposes. Have you figured out where that would land you in the matter at the present rate?

A Well. You see there are two periods there Sir. The period that the Company have taken we will say, is 10 years.

Q Yes?

A Now we cannot then suppose 15 years.

Q But you say they have made some investments that have not run out?

A Oh no, but they are being depreciated on that basis, of ten years, as they occur. We have prepared a statement and submitted it here as to what the situation would be on the basis of what the Company are now actually putting through their records.

Q Which one is that?

A On Page 5, Sir. Dealing with the year 1938, which is on Page 5. Well it deals with all years.

Q You say, I suppose, of course, if they are taking 10% depreciation throughout, it is only concerned with 10 years of life?

A Very true, from the date it commences. On Page 5 it gives the result of what the cost would be on first a basis of direct cost, that we have used, which only differs from

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the Company by the amount of the storage. The indirect costs, of course, will differ because we have used a different basis. I am speaking now of the last figure on this sheet. 2.806 represents the direct operating costs per barrel, and indirect costs we have .938 cents or a total of 3.744 cents. Now the next figure of depreciation is, as per the Company's books, that is what they have actually taken, 1.644 cents per barrel.

Q Is that at 10%?

A Yes, at 10% per annum, yes Sir.

Q Yes?

A Then we go on, and give the total cost before provision for Income Taxes, of 5.388 cents, to which we will add the Income Taxes which are presently in force 2,522 and a small item for losses on sales or retirement of equipment of .019 cents, making a total cost of 7.929 cents per barrel.

Q Yes?

A Now what they actually received by way of revenue works out - and this figure includes the Pipe Line adjustment - 16.850 cents per barrel, resulting in a profit for the period of 8.921 cents.

Q Yes?

A Using our basis of distributing indirect costs, and keeping in mind the difference of the rental of the East Calgary storage, that figure then agrees with the Company's records.

Q MR. COMMISSIONER LIPSETT: That 7.929 cents costs, that includes, however, does it not, Income Tax as based on 56% return on the capital?

A That is correct, sir. That is the actual experience at the moment. Now then to translate that.....

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Q The actual cost apart from that Income Tax apparently will be something like 5½ cents?

A Yes, that is correct, 5½ cents.

Q The figure 5.388 plus the figure of .019?

A Yes, and plus in that a figure for Income Tax and whatever.....

Q Whatever the return would be?

A That is correct. Now you remember I gave some figures and applied what that would mean, and I have the corresponding figures for this particular statement we are looking at. This particular one we are looking at on the basis of 10% cost before Income Tax, is 5.407 cents which you will find - well it is 5.388 plus .018 which is 5.407 cents. The Income Tax would be .446 and 10% return would be 1.583, making a total cost of 7.436 cents per barrel.

(At this stage the Hearing was adjourned until 2 P.M.)

....

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

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[illegible]

[illegible]

[illegible]

[illegible]

....

MR. FRAWLEY: That completes Mr. Morrison's evidence, Mr. Chairman. At least I say it completes it, it completes all that he has at the moment prepared. There are a few small items, a couple of statements which I have asked him specially to prepare, which needs a little more calculation and which can be put in at any time. I am now prepared to call Mr. Taylor. Mr. Nolan is anxious that he should be dismissed as soon as possible.

MR. NOLAN: The gentleman has been here a long time and it is a bad time of the year for an accountant to be away from his office. If he could be called now it would be appreciated.

MR. FRAWLEY: All right, Mr. Taylor.

JAMES WATT TAYLOR, having been recalled, examined by Mr. Frawley said:

Q You have been sworn, Mr. Taylor?

A Yes.

Q I think you might further qualify yourself, Mr. Taylor, for the purposes of the record as to your standing in the accounting profession before Mr. Nolan begins to examine you.

A Yes. I joined the staff of the Montreal office of Price, Waterhouse and Company in 1912; went overseas in 1914; returned in the Spring of 1919 and rejoined the Montreal staff of Price, Waterhouse and Company. In May of 1920 I passed the final examination of the Quebec Institute of Chartered Accountants and became entitled to the degree of Chartered Accountant. I continued on in the Montreal office of Price, Waterhouse and Company until 1922 when I was transferred to the Toronto office of that firm, where I have remained ever since, having been admitted a partner of the firm, of the Canadian firm of Price, Waterhouse and Company, in 1929. For

MR. BRAWLEY: [illegible] completes Mr. Morrison's evidence, Mr. Chairman. At least it [illegible] completes it, it completes all that [illegible] property. [illegible] few [illegible] which I [illegible] asked [illegible] which needs [illegible]

[illegible]: [illegible] it is a [illegible] of [illegible] to be away from his office [illegible] called now it would be appreciated.

MR. BRAWLEY: All right, [illegible]

[illegible] AMES [illegible], having been recalled, examined by Mr. Brawley [illegible]

[illegible] have been sworn, Mr. Taylor?

[illegible] further qualify [illegible], Mr. Taylor, for [illegible] of the record as to your standing in the accounting profession [illegible] begin to examine [illegible] Price, [illegible] in 1911; [illegible] in 1914; [illegible] spring of 1915 [illegible] and Company. [illegible] final [illegible] of the [illegible] and Company [illegible] the Toronto office [illegible] having [illegible] Canadian firm of Price, Waterhouse and Company [illegible]

the past ten years I have sat on the Council of the Institute of Chartered Accountants of Ontario and now first vice-president of that Institute. My work has got me in contact with auditing and accounting problems of all kinds in a very wide sphere, including the examinations into the past earnings of companies, the preliminary issue of circulars issuing, offering securities for public subscription. That work has involved always the relationship of earnings against capital. I have also been called in on occasions to value the shares of the private companies for succession duty purposes, which has involved the going from the earnings, and the establishment of the capital value of the shares. I think that is all I have to say.

Q Mr. Taylor, before Mr. Nolan begins to examine you, I want to ask you something in case I forget it, and you are going away as soon as you have finished I understand, the firm of Price, Waterhouse and Company are auditors for the Imperial Oil Limited?

A Imperial Oils Limited and all its subsidiary companies, including the Royalite Oil Company.

Q And all its subsidiary companies?

A Yes.

Q Your office of course is in Toronto?

A That is right.

Q You are the resident partner of your company in Toronto?

A Yes.

Q The head office of the Imporial Oil Limited is at 56 - Church Street, Toronto?

A I believe the head office is at Sarnia.

Q The head office of the Imperial Oil Company is at Sarnia?

A I believe that is so.

Q You know the extent of the ownership of Royalite Oil Company, Limited by Imperial Oil Limited?

A Oh no, in a general way, it fluctuates from day to day but it is around 70%.

Q Around 70%?

A Yes.

Q Do you have occasion to go to the office of the Standard Oil Company of New Jersey in New York?

A Occasionally.

Q Does the Price, Waterhouse Company in New York audit the Standard Oil Company of New Jersey?

A They do.

Q And all its subsidiaries?

A I would not say that. There are a number of foreign subsidiaries which I think are audited by local auditing firms, where we have no connection.

Q But otherwise wherever the Price, Waterhouse Company operates it audits the various subsidiaries of the Standard Oil of New Jersey?

A That is correct.

Q Can you tell us the extent of the ownership of Imperial Oil Limited by Standard Oil of New Jersey?

A That is the Imperial Oil by Standard?

Q Yes.

A I think it is about 60%, that is to the best of my recollection. I would not make that a definite figure.

Q I will get that exactly, and the local firm of Price, Waterhouse & Company is in every sense of the word a branch of the organization in Toronto of which you are the resident partner?

A The local Calgary office?

Q Yes.

A It is under the management of Mr. Humphries who is our local manager of this office.

MR. FRAWLEY: All Right.

Q MAJOR LIPSETT: Can you tell us those figures, Mr. Taylor, what percentage of Royalite does the Standard Oil own?

A Presumably, presuming the 70 is correct, is Imperial's owning Royalite, and 60 is correct, Standard owning of Imperial, the percentage would be 42%.

Q And I suppose if you find that those figures are not approximately correct you will let us know?

A Yes.

MR. FRAWLEY: I think, Mr. Commissioner, when some of the executive officers of the Imperial come from Toronto we can get all this exactly. In fact I think Mr. Nolan has a note to see that it is accurately obtained, if I am not mistaken, and if you have not, will you make a note now in case it escapes my mind, that Mr. LeSueur or someone should come prepared to give the Commission pretty accurate information about that.

Q MR. NOLAN: Mr. Taylor, I understand you have made an examination of the operating and capital expenditures of the accounts of the Royalite Oil Company?

A That examination has been made under my direction and supervision.

Q And that a report has been prepared under your direction which has been marked in this case as Exhibit "100"?

A Yes.

Q It is dated the 7th of January, 1939?

A Yes.

... the ... who is our ... manager ...

... right.

... can you tell us these figures,

... percentage of Royalties ... the Standard ...?

Presumably, presuming the 70 ... Imperial's on the royalties, ... is correct, ... Imperial, the percent ...

And I might ... that those figures are not approximately correct you will let us know?

Yes.

MR. BRADLEY: ... some of the executive officers ... from Toronto we can get ... I think ... not here ... to see ... accurately obtained, if I am not ... not, will you ... more now ... the Commission ...

... understand you have ... and capital ... Royalite Oil Company

Q And it is addressed to the Royalite Oil Company, Limited?

A Yes.

Q Would you be good enough to take that report and if you wish, read it to the Commission, I think that is the best way of beginning these discussions, Mr. Chairman.

A The first thing I want to point out, Mr. Chairman, is that this report is prepared in the plural, as the report is signed "Price, Waterhouse and Company" but as to any opinion expressed they are purely my personal opinions, although the word""we" appears. The report is dated January 7th, 1939, addressed to the Royalite Oil Company, Limited, 606 - 2nd Street West, Calgary, Alberta.

(Page no. 2694 here follows)

"Dear Sirs:

We have made an examination of the operating and capital expenditure accounts of your Company for the purpose of ascertaining the revenue and costs of gathering and transporting oil over your pipe line system for the period from January 1, 1931 to September 30, 1938 and the rate of return on the capital invested therein, and we have prepared and attach hereto the following statements:

Statement of investment showing rate of return thereon for the seven fiscal years ended December 31, 1937 and for the nine months ended September 30, 1938	Exhibit A.
Statement of average cost and profit per barrel of gathering and transporting oil for the period from January 1, 1931 to September 30, 1938	Exhibit B.
Statements of operations of the Pipe Line Department for each of the seven fiscal years ended December 31, 1937, and for the nine months ended September 30, 1938	Exhibits C1-C8

In connection with these statements we have the following comments to make:

Royalite Oil Company Limited is primarily a producing Company and its revenues have principally been derived from the production and sale of oil and natural gas. It has little or no selling or marketing expenses, its whole output, with the exception of some small sales to drilling companies, being taken by Imperial Oil Limited and the Canadian Western Natural Gas, Light, Heat and Power Company Limited. Incidental to its production operations, pipe lines were

laid for the gathering and transporting of oil from the Turner Valley field to the Calgary refinery of Imperial Oil Limited and from the commencement of the operation of the pipe lines in 1925 until 1936, oil transported was almost entirely for account of Imperial Oil Limited, but from October 1936, oil has been transported for The British American Oil Company Limited and other independent operators.

Administrative and Other Indirect Expenses:

The accounting system followed by the Company provided for the segregation of the revenues and direct expenses of the Pipe Line Department throughout the period from January 1, 1931 to September 30, 1938 covered by the attached statements, but no distribution was made on the books of the administrative and other indirect expenses, which were incurred, in part, in the interests of that Department. It was necessary, therefore, to establish a basis for the allocation of these expenses to the Pipe Line Department in order to arrive at the net profit of the Department. In this connection it should be mentioned that the Company maintains certain utility departments (such as steam and electric light plants) and certain service units which include a water system, forge and machine shops etc. There are a number of bases (all of which are arbitrary) on which charges of this nature are allocated in actual accounting practice, probably the most generally followed being the direct labour basis, which assumes that such expenditures have been incurred in the interests of the operating departments in the same ratio as the direct payroll of each respective operating department bears to the total direct payroll of all operating departments. This

basis has, therefore, been adopted in preparing the attached statements (Exhibits C1 to C8) and the wording set against these overhead charges on the statements describes in more detail the actual basis applied. In this connection it should be mentioned that in making the distribution just referred to the payrolls applicable to capital additions have been excluded, as in our experience it is not the general practice for companies which are in operation to capitalize charges of this nature.

Investment in Capital Assets:

The investment in capital assets shown on Exhibit A. is arrived at on the basis of the dollar value put into the business year by year, less the dollar value recovered on the retirement of capital assets year by year. In applying this basis we have included in the capital assets the 6" Loop Line which was laid in 1929 at a cost of $178,885.02 and taken up in 1932, at which time a recovery value of $76,482.60 is credited to the Investment Account. The application of this "cash" basis also had the effect of adding $56,269.66 to the capital assets as shown by the books over the period from 1925 to 1938.

In arriving at the amount of the investment in capital assets we have taken the balance at the beginning of each year and have added thereto one-half of the additions for the year.

Provision for Amortization of Capital Investment:

In addition to a fair annual income return on his capital while employed commensurate with the risk involved, the investor is entitled to expect also the return of his capital intact within a reasonable time, and, in the case of a wasting asset such as oil, the earnings

of each year should be charged with an appropriate amount to provide for this return of capital; the fate of the pipe line is, of course, inseparably bound up with that of the field which it serves, and, therefore, the same principle applies..

If it were possible to forecast:

(a) The total number of barrels of oil which will be transported in the future over the Company's pipe lines

(b) The additional capital expenditures which will require to be made to handle this throughput

(c) The number of years over which the operation will be spread

then it would be possible to arrive at an accurate annual charge for amortization over the whole period of the operation. As no one of these three factors is capable of being definitely ascertained it becomes necessary to assume a period of time over which to spread the provision for amortization of the capital expenditures which have been made from the commencement of the laying of the first pipe line to September 30, 1938, and to apply the resulting annual charge to the period of seven years and nine months covered by the attached statements of operations. December 31, 1946 has been taken as the date by which the capital should be returned in full, being ten years after the new crude field was brought in, in 1936. The investment in the pipe line fixed assets has been made in varying amounts over a number of years commencing with 1925 and on the basis of amortizing <u>all</u> expenditures by December 31, 1946, it is found that the capital has been returned, on an average, in 13.17 years, which in our opinion, is reasonable, having regard to the speculative risk involved.

C3
52

This calculation does not presume to measure the "life of the field" but is merely a calculation spread over what we consider a reasonable period of years; therefore as no "winding up" is contemplated, salvage value has not been considered.

We wish to report that we have included in our calculations one-half the annual amortization rate on capital additions made during the year on the assumption that, on the average, the expenditures had been completed for one-half of the year.

Rate of Return on Investment:

We have considered carefully the question of the rate of return which capital would be entitled to expect from investment in a venture such as the Royalite pipe line, and give it as our opinion that, having regard to the hazards involved, the rate of income return per annum should be twenty per cent on the investment.

There is a general misconception as to the significance of a percentage arrived at as a return on investment in a calculation such as is set out on Exhibit A. attached hereto, the average person being apt to consider a return of, say, 20% as meaning that $20.00 in cash can be handed over to the investor as his earnings on each $100.00 of capital. Such, indeed, is seldom the case as the full amount of the earnings would probably not be available in cash, having been re-invested in the business in some other form. The position of the Pipe Line Department ~~in this regard is interesting, as shown by the following~~ summary:"

WITNESS: Mr. Chairman, I would ask that as we go along certain of these figures be changed there

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sider a return of, say, 20% as meaning that $20.00 in cash can be handed over to the investor as its earnings on each $100.00 of capital. Such, indeed, is seldom the case as

slightly. Slight errors which I discovered, which do not quite tie up with the other statement. The headings of this calculation are "Total", "Average per Annum", "% of Total". Net profit for the period of seven years and nine months ending September 30, 1938, Total $1,151,098.71, instead of $1,149,222.37, Average per Annum $148,528.86, and the 100% remains the same.

Amount re-invested in the business in the form of net additions to capital assets remains unchanged at $834,000.53. The Average per Annum remains unchanged at $107,612.97. The percentage changes to 72.45%.

The description against the result , which is merely the bottom lot of figures taken from the top, balance of net profit, which was not reinvested in capital assets, $317,098.18, Average per Annum, $40,915.89, and the percentage, 27.55%.

	" Total	Average per Annum	% of Total
Net profit for the period of seven years and nine months ending September 30, 1938	$1,151,098.71 ($1,149,222.37)	$148,528.86 ($148,286.76)	100. %
Amount re-invested in the business in the form of net additions to capital assets	834,000.53	107,612.97	72.45 % (72.57)
Balance of net profit which was not re-invested in capital assets	317,098.18	40,915.89	27.55 %
	$315,221.84	$40,673.79	27.43 %

The putting back into the business of a substantial portion of the annual earnings is part of the past history of every successful company. Whilst it is true that the investor's equity is enhanced through this policy it should

[illegible]

[illegible]

[illegible]

[illegible]

be borne in mind that in this particular case the amount retained in the business has been invested in fixed assets and so has become frozen as capital in a business which is highly speculative.

Working Capital:

It will be noted that in arriving at the capital invested as shown on Exhibit A., there is included the following amounts for working capital:

1937 and 1938	$150,000.00
1936	100,000.00
1931 to 1935	75,000.00

The estimate of the investment in working capital was calculated as follows:

For the nine months ending September 30, 1938, it was found that the withdrawals from the Company's inventories of materials and stores by the Pipe Line Department was 26.7% of the total withdrawals, and it has been assumed that this same proportion of the Company's total inventory as at September 30, 1938, was carried on behalf of that Department:

26.7% of $544,244.00 gives	$145,248.00

To which has been added an amount equal to one month's cash requirements for direct charges as taken from the period of nine months ending September 30, 1938

One-ninth of $141,507.86 gives	15,723.10
Total	$160,971.10

An amount of $150,000.00 has accordingly been taken as the investment in working capital for the years 1938 and 1937, which amount has been reduced for the earlier years,

in which the operations were less extensive.

\- - - - - -

We shall be pleased to furnish you with any further information you may require.

Yours very truly,

'PRICE, WATERHOUSE & CO.' "

Q MR. NOLAN: Now, Mr. Taylor, coming to the statements themselves, which are represented as Exhibits "A", "B" and "C", 1 to 8, is there any particular order which you would like to follow in explaining those to the Commissioners? Do you want to take "A" first?

A No, I think "A" is a summary of the separate statements and I should think it would be better to go to the details from which that statement is made up. The same applies to "B", which is merely a collection in total of the figures for the seven years and nine months. I think I would prefer to go to one of the detailed operating statements and explain just how it has been made up.

Q Then you have, as I understand it, Exhibits "C1 to C8" which take care of this period ended September 30th, 1938?

A Yes, one for each of the years, 1931 to 1937, and one statement for the nine months ended September 30th, 1938.

Q And the set-up of each of those Exhibits is the same in each instance?

A Same in each instance, the same principles applied and ~~the figures set up in exactly the~~ same description.

Q Is there any one of those Exhibits, C1 to C8 that you would prefer to refer to more than any other?

A I think it would be advisable to take the last complete fiscal year, which is the year 1937.

Q Yes, and that will be C7?

A C7.

Q And, of course, you will make reference to the others?

A Oh, yes, I will come back to the others.

MR. FRAWLEY: The one that Mr. Morrison dealt with specifically was C8.

MR. NOLAN: Yes, we will deal with it, but this one first?

A This is the last complete fiscal year.

Q Will you take C7 then and explain to the Commissioners just what this statement is intended to contain?

A The heading of the statement is "Royalite Oil Company Limited, Pipe Line Department, Statement of Operations for the year ended December 31st, 1937."

(Page 2703 follows.)

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

J. W. Taylor.

On the right hand column the costs per barrel are worked out. The first figure we see at the top of the page is the number of barrels transported in that year, 2,431.517 barrels.

Q Yes?

A And the barrel figures appearing on the extreme right hand side are arrived at there and divided into the number of barrels and into various amounts shown on the statement under various headings.

Q So that these figures in the right hand column are per barrel in cents?

A Per barrel in cents on 2,431,517 barrels.

Q Yes. Now as you go along what is your next head, Mr. Taylor?

A Transportations Earnings.

Q Will you just carry on?

A 2,419,804 barrels carried to Calgary, $480,229.11.

Q At the prevailing rate in 1937?

A At the prevailing rate in 1937, and which we notice works out on an average at exactly 20 cents. 23,446 barrels carried to Local Sales Station at Turner Valley, $2,111.94. Adjustment of 1936 pipe line charges $3,983.10. Extended the total is $486,324.15, which too works out at 20 cents per barrel.

Q On the average?

A On the average, yes.

Q That figure $486,324.15 is the transportation earnings?

A Transportation income, yes.

Q Your next big head, Mr. Taylor, is?

A We add up the barrellage and we find that it comes to 2,443,250 barrels, part of which was only carried to the local sales station and for the purposes of arriving at the barrellage, which should be divided into various expenses as noted by the footnote, with the two X's against it, the last footnote on that page, "For purposes of determining the cost per barrel, total barrels carried have been deemed to consist of all barrels carried to Calgary, plus one-half of the barrels carried to Turner Valley local sales station." The next main heading is "Operating Costs". Direct operating costs exclusive of administration and amortization charges, but after providing for automobile depreciation $66,012.61. Administration charges distributed on basis of ratio of direct operating labour of the Pipe Line Department to total operating labour - 7.9110% of $113,675.44, which gives a figure of $8,992.86, and those two amounts extended make $75,005.47, which works out on the rate of 3.08 cents per barrel on the 2,431,517 barrels.

Q In that figure of 3.08 cents we have included direct operating costs, exclusive of administration and amortization charges?

A No, it includes distribution of part of the administrative charges, as indicated.

Q Oh, it is broken up into direct operating costs and administrative charges?

A To the proportion of the administrative charges.

Q And those two added together, the cost of those two items, 3.08 cents per barrel?

A 3.08 cents per barrel.

Q Now the next?

A Proportion of total indirect operating costs (as below) applicable to pipe line department on basis of ratio of operative labour costs of the pipe line department to operating labour costs of all other revenue producing departments - 15.6018% of $169,844.07 - that is the total which appears below - $26,498.73, and a cost of 1.09 cents per barrel.

Q Yes?

A As making up the amount of $169,844.07, we have given below some details of the items making up that total.

Q In other words, you are going to explain how you got the total of $169,844.07?

A Yes sir. Total indirect operating costs (net) exclusive of Administration and Amortization charges, but after providing for automobile depreciation, $114,547.14. Now to these indirect costs there has been allocated a certain portion of the administrative charges, based on the same amount as we used in working out the direct, $113,675.14, and these indirect charges have had allocated to them 42.5560% of the total administration expenses, which amounts to $113,675.14, giving an amount carried out as $48,375.72.

Q MR. COMMISSIONER LIPSETT: Mr. Taylor, if I would not be interrupting. Your figure there of $101,504.00, is that a comparable figure with Mr. Morrison's $96,533.00 for the same year? I mean there is a difference of about $5000.00?

A The $101,504.00 at which point, Sir?

Q That you have come to for that deduction. That figure of $101,504.20, that is direct and indirect?

[illegible]

[illegible]

[illegible]

A Direct and indirect, Sir. Yes sir.

Q Perhaps you haven't it before you but I was just wondering if that was comparable with Mr.Morrison's $96,933.00?

A I would like to see that statement.

MR. NOLAN: Are you reading from Page 2?

MR. COMMISSIONER LIPSETT:- Page 18 of Mr. Morrison's. Just so we can follow it.

A It is comparable, Sir, except for depreciation.

MR. COMMISSIONER LIPSETT: Mr. Nolan, if it is not convenient, I do not want to disturb him now.

MR. NOLAN: Oh, that is all right, sir.

A No sir, it is more comparable to the $96,933.27 in Mr. Morrison's report.

Q MR. COMMISSIONER LIPSETT: That is what I am asking you?

A Yes, it is comparable to it.

Q Those are two comparable figures?

A Those are two comparable figures in 1937.

Q Thank you very much.

A We had considered the first item Total Indirect Operating Costs, exclusive of Administration and Amortization $114,547.14. Then we have distribution of part of the Administrative expenses to the Indirect Costs on the basis of ratio of direct Operating labour included in Indirect Operating Costs, to total operating labour 42.5560% of $113,675.14, giving a figure of $48,375.72. Depreciation on trucks and tractors as charged in the books $7,073.98. Profit on sales and retirements of automobiles and trucks and tractors, as credited in

the books, (net), $152.77, that is the red figure indicating a deduction, giving a total of $169,844.07, which is the amount on which immediately above we have taken a percentage of 15,6018% as the proportion of the total indirect oprating costs applicable to the Pipe Line Department.

Q MR. NOLAN: In that year?

A In this year, 1937.

Q Yes?

A Giving an amount of $26,498.73, or 1.09 cents per barrel. Adding up then the direct and indirect costs we get a total of $101,504.20, and a cost per barrel of 4.17 cents, that being described as the total operating costs before providing for amortization. The next item, Provision for Amortization of Capital Assets on the basis of providing for the cost thereof by December 31st, 1946, Pipe Line Department $53,360.88. Proportion of provision for utility and service units - 15.6018% of $59,316.08 - this percentage it will be noted is the same percentage as appears above in distributing the indirect costs - 15,6018% of $59,316.08, being a total amortization of the utilities, gives $9,254.38, and the total amortization extended of $62,615.26, which, added to the $101,504.20 gives a total cost, direct and indirect, and after provision for amortization of $164,119.46, or 6.75 cents per barrel. That amount taken from the transportation earnings arrives at a profit from transportation before providing for Income Taxes, of $322,204.69. Now the 6.75 cents taken from the 20 cents per barrel above, gives a profit of 13,25 cents per barrel at that point.

The next item is add, proceeds from excess of pipe line deductions for loss of oil in transportation over actual loss, 30,801 barrels, a total of $57,479.63, which works out at 2.36 cents per barrel. We then arrive at a figure of $379,684.32, and a profit per barrel of 15,61 cents. Deducting from that provision for Dominion and Provincial Income Taxes, at the current rate of 22%, the Income Tax works out at a calculation on that amount which is immediately above it, $83,530.55, the Income Tax representing 3.43 cents per barrel. The net profit for the year then becomes $296,153.77, with a net profit of 12.18 cents per barrel, and the little tabulation immediately below that on the right hand side, gives our cost per barrel of 6.75 cents, which can be matched with the figure just a few lines above, and the Income Tax per barrel as 3.43 cents, giving a total of 10.18 cents per barrel.

Q Will you explain that little "X" you have added to this statement, just opposite the pipe line losses, the deduction item?

A Yes sir. Perhaps I could best explain it by reading it, Sir. "Under an arrangement commencing at from September 1st, 1936, the deduction for pipe line losses on crude oil was reduced from 2% to 1%. This change in basis, if applied to the period from October 4th, 1936, to December 31st, 1937, to which this credit applies, would have the effect of cancelling the income from this source and substituting therefor a charge of $188.47." That is the calculation, putting the result of what we know as the pipe line adjustment account, to the basis of the present prevailing rate,

since the 1st September, 1938.

Q Now, Mr. Taylor, do you want to say anything more about that statement, or would you like to go to C-8 now.

A I think if there are any points that you, Mr. Chairman, or Mr. Commissioner would like to ask on that statement. Perhaps we might go over the statement for the nine months ending September 30th, 1938, which is made up exactly on the same basis. Exactly the same headings apply to the actual results for the nine months ending September 30th, 1938, on the basis of the distribution of overhead adopted by us.

Q Yes?

A I am taking the direct expenses, and earnings as shown by the books. It is headed Royalite Oil Company Limited, Pipe Line Department, Statement of Operations for the Nine Months ended September 30th, 1938. The barrels with which we deal in this period is the barrellage actually transported during the nine months and taking the same basis as we did previously, for the purpose of arriving at the total barrels, taking one-half of the barrels which did not come through the main trunk line, but which were sold from the local Turner Valley sales station. We have a figure 4,575,615 barrels. Transportation earnings 4,562,702 barrels carried to Calgary, $685,376.50, and 25,826 barrels carried to local sales station at Turner Valley, $1,936.95. Extended that is $687,313.45 giving an average of 15.02 cents. There was a variation of the rate in this period which brings it

that it does not work out at an even number of cents per barre . Operating costs. Direct operating costs exclusive of administration and amortization charges, $142,984.72. Administration charges distributed on basis of ratio of direct operating labour of the pipe line department to total operating labour - 13.5849% of $102,110.25, giving a figure of $13,871.58, a total of $156,856.30, or a figure of 3.43 cents per barrel. Proportion of total indirect operating costs (as below) applicable to pipe line department on basis of ratio of operating labour costs of the pipe line department to operating labour costs of all other revenue producing departments,- 28.9996% of $190,439.92 or $55,226.82, making it 1.21 cents per barrel.

Q And then you proceed?

A Then we proceed to give the detail of that amount in the same way as we did in the previous year.

Q That amount being $190,000.00?

A $190,439.92, which is the amount dealt with in carrying out the percentage immediately above.

Q Yes.

A Which gives us an amount of $55,226.82 or 1.21 cents per barrel. These items making up the $190,000.00 odd dollars are; "Total Indirect Operating Costs (net) exclusive of administration and amortisation charges, $132,560.03. Administration charges distributed on basis of ratio of direct operating labour included in indirect operating costs to total operating labour - 46.9625% of $102,110.25 is $47,953.53. Depreciation on automobiles and trucks and tractors as charged in the books $10,531.19. Profit on sales

and retirement of automobiles and trucks and tractors, as credited in the books, (net) $604.83, which constitutes a deduction. Then we arrive at the total operating costs before providing for amortization, and that is - well I should say that is a total of $190,439.92. Which is the amount which speaks above, and on which the percentage of 28.9996% is calculated and gives us our figures of the proportion of the indirect operating costs.

Q THE CHAIRMAN: At what rate are automobiles and trucks and tractors depreciated on the books, do you remember?

A I rather think it is 25% for the first year and 20% for the next following year. I cannot speak definitely. But I know the usual rate on trucks and automobiles is 25%, which they step down to 20% and 15%.

Q 25% the first year, 20% the second year and 15% the third year?

A Yes, my Lord. We have dealt with the direct and indirect costs, and we find that the total operating costs before providing for amortization is $212,083.12, which works out at 4.64 cents per barrel.

Q MR. COMMISSIONER LIPSETT: Mr. Taylor, before you pass from that, would you give us a little more explanation of the variations in the three percentages, 13%, 28% and 46%?

A Yes sir. We take the administrative charges first. We take all our operating payrolls of the whole Royalite Company, and we list each payroll and its amount, and it makes a certain total which we call 100%. Then we distribute that 100% by taking the relationship between

the amount applicable to this department and the total, and it works out in the case of the direct labour chargeable against pipe line department at 13.5849%.

(Go to Page 2713.).

Of the total administrative charges which are $102,110.25.
In fact it follows on from there, there is another figure which was arrived at at the same time, distributed to the utilities and the indirect costs, that emerges at the same time the 13.5849, those payrolls being the net proportion of the total and the direct pipeline labour being 13.5849 of the total. We distributed the same amount and each of those two, the direct labour takes 13% and the indirect or the labour and the indirect section, that is the utilities and the service units take 46.9625%.

Q MAJOR LIPSETT: Then your total administrative charges are $102,110.25?

A That is right.

Q You first of all take 13.58% of that?

A Yes.

Q And charge that up as $13,871.58?

A That is on the direct payroll of the pipeline department.

Q I follow that, Mr. Taylor. Then you take the next one, where you take the 46.9625% of the same total, of $102,110.25, was what I couldn't quite follow you?

A Yes, that is distributed, the same amount of $102,000 and as I said we list the total payroll of all operating departments, taking them item by item, one by one and we get the total amount of money which is 100%. Then we take each individual one and arrive at the proportion that it is of the 100% and we find that the direct pipeline labour, that the direct pipeline payroll is 13.5849% and the utilities and service units portion is 46.9625%.

Q Well of the administrative costs, will it work out this way, Mr. Taylor, that you first of all charge 13.5849%?

A Yes.

Q And you also charge 28.9996%?

A No sir.

Q That is not right?

A No sir, excuse me a moment, sir, no sir, it does not quite work out that way. If you look at the little tabulations underneath there?

Q Yes.

A First of all we take in the direct costs 46.9625% and that gives an amount of $47,953.53 of which only 28.9996% is then charged back, so it is really 28,roughly 29% to 47% that goes back in and is distributed.

Q Indicated in that $55,226?

A That is right.

Q But then on top of that, higher up, you charged 13.5849% of $102,000 which gives $13,871?

A That is right.

Q That is what I was talking about.

A If I could make just a rough calculation without taking all these decimal points.

Q Yes, certainly, if it is interrupting you, Mr. Taylor, I do not want to interrupt?

A No, not at all.

THE CHAIRMAN: We might take five minutes while Mr. Taylor does this.

(A Five Minutes' recess Was here taken).

Q MR. NOLAN: Now, Mr. Taylor, you were going to explain to the Commissioners the difference in these percentages and did I understand you were going to make a calculation which would make it clear?

A Yes, I have made a caclulation and in the first, the figure referred to, Mr. Commissioner, was this figure of $13,871.58

as being distributed direct and you asked me as to how much additional came through this allocation down below. We distributed 46.9625% of the 102 thousand and then we took 28% of that, which gives practically an equivalent amount, to $13,871, it gives $13,905 additional that goes through this other distribution. I had worked out here, Mr. Commissioner, the calculation on 1937 which covers the same point which you are going into now and which I think it might be helpful to enable you to---

Q MR. NOLAN: The principle is the same?

A Yes, the principle is the same in all of these, this is 1937.

Q MR. NOLAN: I think perhaps that should be marked sir.

A I have 1938 here too, the nine months, I had it, perhaps it would be better to look at it as it is the one we are discussing, can I withdraw that and give the 1938?

(STATEMENT PRODUCED BY THE WITNESS HERE MARKED AS EXHIBIT "104").

Q All right, now take this Exhibit "104", Mr. Taylor, let us see if we can understand the percentages and how you have used them.

A The payrolls are listed.

Q Now just to go back a minute, this is a distribution of administrative overhead and only that, is it not?

A The top is the distribution of administration overhead for the nine months ended September 30th, 1938, and we have the operating labour for other companies and for local sales station $19,549.40. Shall we leave the percentage for the moment. Service units, utilities, etc. $148,259.09. Crude oil production, natural gasoline, gas, gas gathering etc.

$105,000.98; oil gathering, trunkline operating $42,886.88, the total is $315,696.33. Capital expenditures, including construction and drilling $311,229.97, a total of $626,926.30. Now the percentage on the right-hand side stops at the total of $315,696.33. The $315,696.33 is 100% and we take the proportion representing, which the $19,549.40 bears to the total and we find it is 6.1925%; the next item is 46.9625%; the next item 33.2601%; the next item 13,5849% and those four items together make up the 100%. Now those percentages may be followed into the statement.

Q Let me go back a moment, when you say "payroll" what do you mean by that, those are the amounts of money shown on the payrolls of the Royalite Oil Company as being attributal to the various headings which you have enumerated under "operating labour"?

A Yes.

Q And what does this "operating labour" mean?

A The wages expended on---

Q On operations?

A On operations, on labour which is engaged on the operating departments of the company.

Q All right, and you are not taking into consideration the labour expended on capital expenditures?

A No.

Q You are just dealing with what we call "operating labour"?

A "operating labour".

Q And of that operating labour the trunkline department contributed $42,886.36, or a percentage of 13.5849%?

A 13.5849%.

Q And that is the first percentage which you have used in your statement in Exhibit "100"?

A That is right.

Q That 13.5849%?

A Yes.

Q Of $102,110.25?

A Yes.

Q Now that has to do with the administrative expenses overhead only?

A Yes.

Q Only. Now you have some indirect expenses which you are going to distribute, that is the second part of Exhibit "104"?

A Yes.

Q Now will you explain that to the Commissioners, please.

Q MAJOR LIPSETT: Before you pass on from this first one, Mr. Taylor, does that method of dividing it up mean that construction and drilling, this second item of capital expenditure, contributes nothing towards the service units or utilities?

A No, there is no distribution of capital expenditure to this amount of administrative overhead.

Q MR. NOLAN: This is only operating labour?

A Operating payrolls.

Q MAJOR LIPSETT: Yes, but the service units and utilities I suppose are used for all purposes, are they including new construction?

A They might be to some extent but the basis, my basis for not distributing administrative expenses to capital is that you have certain fixed charges in the way of administrative expenses, which are going to be incurred in any case, whether there is any capital expenditure going on or not. You might say it is the company's annual charge which the profit and

loss account should bear and if in one year you have some capital expenditure and take away a portion of that and distribute it to capital expenditures, the expenditure being as I say a fixed charge, you might say, in amount, you are going to fluctuate your profits to my mind artificially. Assuming, let us take it this way, we have exactly the same amount of administrative expenses in two years, two following years. Now the amount of those administrative expenses will be the same in those two years---

Q MAJOR LIPSETT: You mean whether there are capital additions or not?

A Yes, whether there are capital additions or not, and supposing half your payroll is capital expenditure payroll, as seems to have been the case in this year from that statement, then your profit and loss account is artificially changed to the extent of half of the administrative expenses by the distribution to capital expenditures, although had there been no capital expenditures the amount of those expenses would have been the same and the principle of not distributing to capital expenditures, if those expenses had been increased through the capital expenditures, if those expenses had been increased in amount I would agree that some, whatever is represented by the increase which could be laid at the door of the capital expenditures, could be taken out and distributed to that capital expenditure.

Q MAJOR LIPSETT: You think that same principle applies, do you, to the service units used?

A Yes, there is a certain minimum fixed expenditure which we must make to keep our operations going. We are in the business of producing oil, and taking that oil over the pipeline, that is the business we are in and that business

should stand its normal annual charge and should not be fluctuated back and forth as to whether or not you are making capital expenditures. My submission is that it gives you an artificial fluctuation on your operating results and from my observation, Mr. Commissioner, in the manner in which administrative expenses and these indirect expenses moved, having studied them over these four years, I find whether they are making capital expenditures or whether they are not, the amount actually spent under the heading of "administrative" and under the heading of "indirect" do not fluctuate at all. They certainly are not increased in years when capital expenditure has taken place.

Q MR. NOLAN: Well now, turning your attention to the second part of Exhibit "104", I see it is entitled "distribution of indirect expenses on labour basis"?

A Yes.

Q Now you have divided that up again I see and would you explain the division you have there?

A The division in the case of the second section, the distinctive difference between this allocation and the allocation in the upper half of the statement is that administration in this case is only to the revenue producing department, we have already distributed a portion of the administrative expense to indirect expenses so that the labour, the payroll of the service units and utilities do not come in to this next calculation. We distribute on the basis of production, of revenue producing departments only. That is the payroll excluding capital expenditures and excluding the utilities and we get the percentage of 28.9996% against the pipeline which is the percentage which can be traced to Exhibit C8.

Q And which is the proportion of the total indirect operating costs which you apply?

A That is correct.

Q MAJOR LIPSETT: Those figures must overlap a little somewhere, Mr. Taylor, they do not correspond with the figure on C8, I do not know whether there is any adjustment which is simple?

A Which one do you refer to?

Q Well would you take the 28.9996% of, is a division of the sum of $147,887.34?

A We will take 28.9996% of $190,499.00.

Q MR. NOLAN: What the Commissioner is saying to you, Mr. Taylor, is why are you not taking 28.999% of the figure shown on Exhibit "104", why do you take it on the figure shown on Exhibit "100" on the whole $190,439; let me put it to you, is not this statement Exhibit "104" merely for the purpose of arriving at the percentages which shall then later be applied?

A Yes, that is it.

Q And what 28.9996% means is that that is the proportion or relation which $42,886.86 bears to $147,997.84?

A That is right, that is purely payroll, those are the payroll amounts.

Q Those are the payroll amounts?

A Yes.

Q Yes.

A Then we take the percentage which emerges here, the 28.9996% and the only thing we get from this statement, Mr. Commissioner, is the percent, and we take that percentage and we apply it to the $190,439.92, the details of which are just underneath, and so we get this amount of $55,226.82.

Q But we do not find the 190 thousand figure on Exhibit "104".

MAJOR LIPSETT: I think I have got it.

WITNESS: We get the percentage out of Exhibit "104" and apply it on the figures as disclosed in Exhibit "100".

MAJOR LIPSETT: Thank you.

MR. NOLAN: I hope that is clear.

MAJOR LIPSETT: Yes, I think so.

WITNESS: Mr. Commissioner, I think at this time on account of the two steps which we have taken in distributing this overhead, it might be well for me to file the percentage which gives the exact comparison with the Harvey-Morrison percentages, which I now tender.

(STATEMENT PRODUCED BY THE WITNESS HERE MARKED AS EXHIBIT "105").

Q MR. NOLAN: Now what is Exhibit "105", anything to indicate?

A Exhibit "105" is marked "Royalite Oil Company Limited, pipeline department, comparison of percentages of administration and indirect costs allocated to the pipeline department by Price, Waterhouse and Co. and by Harvey and Morrison", shall I read it over?

Q Yes, read it to the Commissioners.

A The headings are "Year", "Price, Waterhouse and Co. percentages", "Harvey and Morrison, percentages". 1934, Price, Waterhouse and Co. percentage is 10.86695, Harvey and Morrison 7.94142; 1935 Price, Waterhouse percentage 10.25055, Harvey & Morrison percentage 4.25365; 1936 Price, Waterhouse percentage 12.20245, Harvey & Morrison 8.28807; 1937 Price, Waterhouse percentage 15.09356, and Harvey & Morrison, 14.18656; 1938 Price, Waterhouse 28.24993, Harvey & Morrison 18.29067.

Q Now these Harvey and Morrison percent figures, Mr. Taylor, are taken from Mr. Morrison's report?

A Directly from his report.

Q And are the percentages that he used to distribute the indirect costs in each of these years 1934 to 1938 inclusive?

A The administrative and indirect costs.

Q Then you show what your percentages are for those years?

A Yes.

Q And what have you to say about that comparison which you have made?

A This comparison places those percentages in exact relationship with the Harvey and Morrison percentages.

Q Yes.

A It involved the working out of these different steps which we took in distributing, all that one might show, I showed it, and we arrived at the percentage which is primarily comparable with the Harvey & Morrison percentage.

Q But not comparable in amount?

A Not in amount, in percentage only.

Q Well I notice that their figures have what I called this morning a "dip" in them, there is no "dip" in yours, yours go up all along the line from 1934 to 1938?

A That is right.

Q Have you anything to say about that?

A I think that---

MR. FRAWLEY: He does dip a little bit from 1934 to 1935, Mr. Nolan.

WITNESS: I think that those percentages, the fluctuations in the percentages that took place in the Harvey & Morrison percentages between 1934 and 1935 and 1936 are a direct proof I might say of the manner in which operations, earnings are fluctuated by the distributing expenses

penses to capital expenditures in years where there are capital expenditures, distributing to those expenditures and capitalizing charges, administrative charges and indirect charges, which would have been going on in any case whether there were capital expenditures or not, and another point about them is that we have here the pipeline department affected by this distribution, whereas the work which was actually being carried on, the capital expenditure work which caused that so-called dip was expended on the constrcution of an absorption plant. I cannot see why the earnings of the pipeline department should be affected because we were building an absorption plant to the extent of the putting or distributing of those expenses which would have been going on in any case, by cutting them in half, which is the effect of this proration of these overhead, these administrative and indirect expenses to capitalization.

Q Well now, Mr. Taylor, you were in the process of discussing the 1938 statement, being C8 of your Exhibit "100"?

A Yes.

Q And you were asked by Mr. Commissioner Lipsett to go back to these percentages which you have just done. Now going on from there, without going into all the detail which is contained in the language used on the left of these sheets, perhpas you can just summarize for us what the position is in barrels?

A You get down to the total operating costs before amoritizing---

Q Of 4.64¢ per barrel?

A Yes.

Q And then you proceed to provide for amortization?

A The amortization charge works out at 1.88¢ per barrel, giving

per [illegible] in years there are [illegible] capital expenditures [illegible] to those expenditures [illegible] and [illegible] have been going on in any [illegible] or not, [illegible] about them [illegible] here [illegible] distribution, [illegible] constructions [illegible] contribution [illegible] the [illegible] there are [illegible] in any one, [illegible] those [illegible]

[illegible] 30 [illegible]

[illegible] Commission [illegible]

[illegible]

a total of 6.52¢?

Q Per barrel?

A Per barrel.

Q Yes.

A Perhaps I should say in connection with the amortization charge, I might say that our basis of amortizing is on exactly the same principle as Harvey and Morrison, that is our method of working it out. In that way, taking into each year an amortization of one-half of the additions of that year, that is the basis which has been used by both of us and which I think is proper but the capital values we have used are on a different basis.

(Go to page 2725-)

A Another difference is the fact we are amortizing this investment over a period ending December 31st, 1946. That is the basis of all these calculations.

Q MR. NOLAN: Any difference between you is in the value of the capital investment to begin with?

A The length of time that it takes to amortize.

Q Yes. There is no difference in the principle of amortization being used by your two firms' representatives?

A Except that this calculation does not take in any salvage value, as I say in my report. But the principle of taking each years' additions back to 1925. That is another basis on which we differ. We take the additions back to say 1925, and we will amortize them on the buying date, which is the bearing date with us. Take the additions in the next year and amortize them up to the end of the period. Take the next year and so on. So that there is a higher charge each year against each year's earnings for amortization because as you go along you pick up the additions that have been made year by year and you arrive at, you are making your calculation say for 1937 and you have collected the annual charge for each one of those years, which is going to amortize it at the given date. Each year you have a larger amount, From this point onward, of course, no one of us can say what the capital expenditure is going to be, but following on from that you would in 1939 pick up the 1939 additions and so on until you got to the point that in this calculation if you made any capital expenditures in 1946 you get them back in the year, within the year. So you would have your capital 100% back by December 31st, 1936.

Q THE CHAIRMAN: Has the company been amortizing on

this basis during these years you have been auditing?

A No, sir.

Q Why didn't you change or suggest a change in their method of amortizing, or did you?

A The company's provision was not an amortization charge. I sense the difference between an amortization charge and a depreciation charge. Amortization visualizes the spreading of a charge over a number of years to, you might say, something other than the physical life of the asset. If you take a thirty year period as the life of the field, for instance, then you would amortize over that thirty years. It may be that within that thirty years portions of that equipment will have to be replaced, its usefulness coming to an end through wear and tear. That would be the depreciation feature. And that is the basis on which the company set up its charges and its books on the depreciation basis, looking to write off an asset over its useful life.

Q Instead of giving their capital investment a life of ten years?

A On the average.

Q A useful life of ten years, regardless of whether there would be plenty of oil thtt these lines could serve for a longer period?

A Correct, my lord.

Q You were auditing, and I suppose you considered whether or not there was a proper basis for assuming that the life of the line would be about ten years?

A Yes, sir. We considered as we went along auditing the company's accounts from year to year the basis on which they were setting up depreciation and it seemed proper, always having in mind that the assets were sitting under the risk of oil being produced in Turner Valley, that

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would be so far as these assets which would have a longer physical life than ten years.

Q MR. NOLAN: Mr. Taylor, if you will deal with this statement, Exhibit C8 of Exhibit "100". You were going to show that the profits from transportation before providing for income taxes, on a cost of transportation of 15.02¢ per barrel was 8.50¢ per barrel?

A That is profit from transportation before providing for income taxes?

Q And then you add?

A Add pipeline deductions for losses, 1.83¢ per barrel, and we get a figure of 10.33¢ per barrel, from which we take provision for income taxes, which is an exact calculation on the profit.

Q Yes?

A Of 2.27¢ per barrel, leaving a profit of 8.06¢ per barrel.

Q Then you have this little supplementary calculation at the foot of the page, which you referred to before?

A Yes. The cost per barrel, 6.52¢, income tax per barrel, 2.27¢, making a total of 8.79¢ per barrel.

Q Yes. Well, now, perhaps you will go back just to 1931, which is statement C1?

A Yes.

MR. NOLAN: Now, each of these, my lord, is easily found, because C1 is for 1931, C2 is 1932, and C3 1933. Now, looking at C1 on Exhibit "100", the transportation earnings there are per barrel?

A 17.41¢.

Q Yes, then you take out your operating costs, in C1, being the year 1931 as at December 31st?

A For the year ending December 31st.

Q Yes, the earnings per barrel , 17.41¢?

A Transportation earnings per barrel, 17.41¢.

Q Yes?

A Operating costs, 7.62¢ per barrel.

Q Yes?

A That is the direct operating cost.

Q Yes?

A And the proportion of the indirect operating costs as stated there, making a total of 8.29¢ per barrel.

Q Yes?

A As being the total operating cost before providing for amortization . The provision for amortization is 3.62¢, making a total cost at that point of 11.91¢. The 11.91¢ taken from 17.41¢ gives a profit of 5.50¢. Provision for Dominion and Provincial Income Taxes, .83¢, taken from the 5.50¢ leaves a net profit for the year of 4.67¢. And the tabulation below again, cost per barrel 11.91¢, which can be traced to the fourth figure above. Income tax per barrel,.83¢, making a total of 12.74¢.

Q MR. COMMISSIONER LIPSETT: Mr. Taylor, comparing that figure now, the cost per barrel on that schedule, with schedule C8, the total cost per barrel in 1931, apart from income tax, but including amortization and depreciation?

A Yes.

Q In 1931 was 11.91¢?

A That is right, sir.

Q Is that right?

A That is right, sir.

Q Now, when you come to 1938, the including cost figure there before income tax was the difference between 10.33 and 15.02¢ was it not?

A No, sir, 8.06.

Q That is taking off the income tax?

A Yes, sir, that is right. You see the figure 6.52¢ in that right-hand corner?

Q Yes?

A If you trace it up to the figure of $298,317.59, you will find 6.52¢ as the total cost at that point.

Q Is not that the total cost less 1.83¢ the profit that you made on the pipeline losses?

A No, that 6.52¢ figure, it is the cost before applying the revenue from the pipeline adjustment account.

Q If you make that adjustment there is not your total cost before income tax in 1938 about 4-2/3¢ per barrel?

A It would be 6.52¢, less 1.83¢, about 4.69¢ per barrel.

Q 4.69¢?

A Yes, about 4-3/4¢.

Q And that 4.69¢ per barrel of cost in 1938 corresponds with 1931, when it was costing you 11.91¢ per barrel?

A Yes, sir, that would be right. Although I scarcely think it is quite proper to relate the pipeline adjustment figure to the cost, because that might be a very varying factor and is a very varying factor in these nine months ending September 30th, 1938, when one applies the present rate of loss.

Q It is amended in fact to some extent at the present time by a reduction from 2% to 1%?

A Yes. The change took place on the first of September, 1938, the change to the 1% allowance.

Q So there is only one month reflected in these figures?

A Yes. We have a little foot-note on that statement, which shows what the result would have been on the 1% basis.

On this Exhibit C8, perhaps I might read the foot-note, which explains that. "Under an arrangement commencing as from September 1st, 1938, the deduction for pipeline losses in crude oil was reduced from 2% to 1%. This change in basis, if applied to the eight months ending August 31, 1938, would have the effect of reducing the income from this source from $83,694.31 to $33,491.82." Now, that figure of thirty-three thousand dollars is very closely paralleled by the figures that Mr. Morrison gave for the concluding three months of 1938, when the operations were on the basis of 1% deduction, and his figure was some eleven thousand dollars. So that the results for the last three months of 1938 were just about the same rate as we by this notation calculate what the first nine months would have been. And that, of course, would be a varying factor according to the losses experienced.

Q MR. NOLAN: Would you mind reading your foot-note on the bottom of page C7, and show what your experience would have been?

A The foot-note to Exhibit C7 reads as follows: "Under an arrangement commencing as from September 1st, 1938, the deduction for pipeline losses on crude oil was reduced from 2% to 1%. This change in basis, if applied to the period from October 4, 1936, to December 31, 1937, to which this credit applies, would have the effect of cancelling the income from this source, and substituting therefor a charge of $188.47". I have those calculations from which that is worked out and, perhaps, I could file them, Mr. Chairman?

Q Are you saying if the rate on pipeline losses had been in 1937 what it was in 1938 it would have shown a loss instead of a profit?

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J. W. Taylor.

A On what it was from the first of September, 1938.

Q 1%?

A 1%.

Q There would have been in 1937 a loss of $188.47 instead of a profit?

A That is our calculation.

MR. COMMISSIONER LIPSETT: It is only right to point out in 1937 on the rate that they had charged there was a profit of 2.36¢ per barrel, which would have to come off your total, it would have to come off the 6.75¢, which it cost them. It would reduce the actual cost to something like 4¼ or 4½¢ a barrel, the actuql cost in 1937. Mr. Taylor, perhaps you would work them out for both years and give us the figure exactly on that?

A I will beglad to work that out, sir. But I do not think that the two elements are quite related.

Q I do not think they are. In fact, in both years the company has made a substantial profit, amounting to a couple of cents a barrel?

A Oh, yes, there is no doubt about that.

Q Amounting to 1.83¢ for 1938 and amounting to 2.36¢ in 1937?

A Yes, sir, those are our figures , sir, as shown.

Q MR. NOLAN: That brings us to the end of the year 1937, does it not, Mr. Taylor?

A Yes.

Q December 31st?

A Yes.

Q Have you anything else you would like to say in respect of that year? If not, where shall we go?

A There is nothing more.

Q Shall we go back to 1931, which we were discussing a moment ago?

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THE CHAIRMAN: Well, I think, perhaps......

MR. FRAWLEY: Before adjourning, Mr. Morrison has asked me to get from Mr. Taylor some break-downs for him which might as well go on the record. In your Exhibit C8, give us a break-down of the figure of $102,110.25. That is in the morning, of course?

A Yes.

Q And $132,560.03?

A Yes, sir.

Q And then have you got these statements such as Exhibit "1C4" for all of the years that you have given us from 1934 on? Mr. Morrison would like to have those. You did produce the 1937?

A Yes.

Q Have you got the 1934?

A I do not believe they are prepared, but they can easily be worked out. Possibly I could have them for you by the morning.

Q Thank you very much.

(At this stage the hearing was adjourned until 10:30 A. M. January 24th.)

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J. J. FRAWLEY

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The Province of Alberta

IN THE MATTER OF THE PUBLIC
INQUIRIES ACT

—and—

IN THE MATTER OF a Commission, dated the
12th day of October, A.D. 1938, to inquire
into matters connected with Petroleum
and Petroleum Products

Commissioners:

The Honourable MR. JUSTICE McGILLIVRAY
(*Chairman*)

—and—

L. R. LIPSETT, ESQ.

Session:

CALGARY, Alberta JANUARY 24th, 1939

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VOLUME 21 - January 24th, 1939.

Witnesses:

E X H I B I T S

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JAMES WATT TAYLOR,

having been recalled, examined by Mr. Nolan said:

Q Now, Mr. Taylor, at the adjournment last night you were discussing what we call our "C" statement of Exhibit "100".

A Yes, but Mr. Nolan, before you commence my testimony this morning I think I should hand in certain statements which were asked for by Messrs. Harvey and Morrison just before the adjournment yesterday and I have all the information here.

Q You were asked to break down two figures, Mr. Taylor, one was the figure of $132,560.03 appearing on C-8?

A I have that statement here, this shows the details of the statement of indirect operating costs for the nine months ended September 30th, 1938, showing the details making up the amount of $132,000.

(STATEMENT PRODUCED BY THE WITNESS HERE MARKED AS EXHIBIT "106").

Q Then the break down of the figure of $102,110.25?

A That is the administration expenses for the nine months ended September 30th, 1938.

(STATEMENT PRODUCED HERE MARKED AS EXHIBIT "107").

Q Now turning---

A There is another statement.

Q I beg your pardon.

A A statement showing the distribution of administrative overhead on labour basis and distribution of indirect expenses on labour basis for the period of four years and nine months ended September 30th, 1938.

(STATEMENT PRODUCED HERE MARKED AS EXHIBIT "108").

Q Now that is all you were asked to prepare, Mr. Taylor?
A Yes, that is all.
Q Now you were discussing yesterday afternoon the details of your statement "C"?
A Yes.
Q And I think I will now ask you to leave those statements, you having explained the principle in them and the same principle being applied in each one of those statements?
A Yes, and there is nothing additional to add in respect to anyone of them.
Q All right, they speak for themselves?
A Yes.
Q Now will you direct your attention to Exhibit "B" in Exhibit "100"?
A Exhibit "B" is described as statement of average costs and profits per barrel of gathering and transporting oil for the period from January 1st, 1931 to September 30th, 1938. Now the various headings or could we call them "side-headings"?
Q Yes.
A Are exactly the same description as in Exhibits C1 to C8, and to my mind the only interesting feature there is the average cost per barrel which is brought out in the extreme right-hand column of the statements.
Q All right, this is statement "B" in Exhibit "100" you are directing our attention to?
A That is right.
Q And you say it is drawn in precisely the same manner in which the statements "C" are drawn?
A Yes, and as a matter of fact it merely collects the total figure shown on C1 to C8 and puts them in one total against the total barrelage for the same period.

Q It is a composite statement?

A It is a composite statement of C1 to C8; in other words if we take C1 to C8, those eight statements, and add up the figures under the different heads, we come to these totals which are in this statement here.

Q And these totals are the average cost and the average profit per barrel on gathering and transporting oil between the 1st of February 1931 and the 30th of September 1938?

A The 1st of January 1931.

Q The 1st of January, 1931?

A And September 30th, 1938.

Q Yes. Well then will you just be good enough to draw the attention of the Commissioners to this right-hand column which is the important column, being in cents per barrel, do I understand that you have the average transportation earnings per barrel 19.58¢?

A That is correct.

Q That takes into consideration the fluctuations of the price on transportation during this period?

A Yes.

Q You have the statement by you, Mr. Chairman, it is "B" we are talking about. Now then what happens to this figure of 19.58¢?

A I think the first figure we should consider is the barrelage figure of 11,926,671.

Q Yes.

A Which is the total number of barrels transported between this period of seven years and nine months.

Q Yes.

A The average transporation earnings per barrel works out at 19.58¢ per barrel.

Q Yes.

A The direct operating costs at 4.45¢ per barrel; proportion of

total indirect operating costs applicable to pipe line department on basis of ratio of operating labour costs to pipeline department, 1.18¢, giving a total direct and indirect costs of 5.63¢ per barrel; provision for amortization on the basis provided for the cost of the fixed assets, the total cost by December 31st, 1936, gives a figure of 3.02¢ per barrel, making a total cost of 8.65¢ per barrel and taking the 8.65¢ per barrel, being our total cost including amortization, we arrive at a figure of profit, taking the 8.65 from the 19.58, of 10.93¢ per barrel.

Q Before providing.

A Before providing for income taxes and before taking into the income account the proceeds from the, what has been always referred to as "the pipeline deductionaaccount".

Q Yes.

A We next take in the proceeds from the excess of pipeline deductions forloss of oil over actual loss, which gives a figure of 1.18¢ per barrel, making the profit then 12.11¢ per barrel, from which is deducted provision for Dominon and Provincial Income Taxes, which is an exact computation at the prevailing rate,- I should correct myself there, this calucalation of Income Taxes, collects the actual Income Taxes provided in the C1 to C8 statements and during that seven years and nine months there was a fluctuation in Income Taxes but that fluctuation is taken care of here in this statement and this statement is the actual total regardless of change of rate. In other words, it is the average, the average of the Income Taxes over the period works out at 2.46¢ per barrel, leaving a net profit of 9.65¢ per barrel.

Q Then there is your supplementary---

A Then there is a summary underneath. The average cost per barrel of 8.65¢, the average Income Tax per barrel being the Income Tax actually paid or which actually would have been paid, perhaps we are getting a little past there, we have merely broken up those profits out of the general books of the company and we are making our calculation and we arrive at a certain profit and we apply the Income Tax rate which was current in the respective years?

Q To that profit?

A So when I say the Income Tax was paid, that is not strictly correct, but that is the Tax which would have been paid on those profits in the year in which they were made. In other words the rate fluctuates in the period I think from 15% to 22% but this amount takes all those calculations at those varying rates and arrives at this total amount which is an equivalent of 2.46¢ per barrel, those two figures together, the average cost per barrel and the average Income Tax per barrel, makes 11.11¢ per barrel.

Q MAJOR LIPSETT: On that Income Tax, Mr. Taylor, is that the Income Tax which would have been payable if your amortization had run over to 1946?

A Yes, that is right.

Q It is not the Income Tax which would have been payable on the basis of 10% depreciation?

A No sir. All these calculations are based on completely amortizing the fixed assets by December 31st, 1946.

Q So that if you doubled the amortization, which is practically what you are doing, if you are depreciating over 10 years, as the company did in the books, you would escape paying a lot of those Income Taxes which you are now charging up, would it not?

A As a matter of fact this calculation of amoritizing arrives at the average number of years that the capital is employed, of

some 13 years.

Q 13 years plus 8 more?

A No sir. In that way we must remember that some of the capital went into this venture as far back as 1925.

Q Yes, just follow that up, you are amortizing that now in the accounts between then and 1946, are you not?

A Yes.

Q That means you are amortizing it over 20 years?

A That is it.

Q But when you are going to pay the Government Income Tax, you are treating it as amortized over 10 years?

A Actually the company on its books---

Q Yes.

A Yes, that is correct.

Q You never in fact paid anything like these Income Tax sums which you are charging here now, have you?

A Well I would like to, I have not made a calculation but a calculation would bring that out and which I would like to make is that I would like to measure the average amortization here with my average capital and just show where it works out.

Q Even the last capital would be amortized over 10 years, the earlier capital would be amortized over 20 years?

A Yes.

Q That means you would only be taking five per cent for depreciation, to fix the rate, but when you are dealing with the Income Taxes you were taking 10% off and paying that much less Income Tax, is that not the picture?

A Yes, that is the picture. These statements are made out entirely on the basis of getting all the capital back by December 31st, 1946.

Q So far as these earlier items of Income Taxes are concerned,

[illegible] ment [illegible]

[illegible] amortization [illegible]

[illegible]

[illegible] compa[illegible] [illegible]ks——

[illegible]

[illegible] ly, I have not made a calculation, but [illegible]

[illegible] ng that [illegible], which [illegible]

[illegible]

[illegible] be amortized [illegible]

[illegible] company [illegible]

[illegible] 10% off [illegible]

[illegible] picture. [illegible]

[illegible] statement [illegible]

[illegible]

they are not a picture at all of the actual facts.

A I would like to make if I may, sir, it would take me a few minutes to make, a calculation as to what that would be. May I sit down my Lord.

THE CHAIRMAN: Yes.

(Go to page 2741)

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

A I find, Mr. Commissioner, I cannot make that calculation from these figures, for the reason that if you will notice the average, in looking at the statement on the right hand side, the average of the gross assets has not been carried out, and that is a figure which I would require to make my calculation, for depreciation purposes, and that is a figure on which that calculation would have to be made. Working out of that average over a period of 7-3/4 years would take me a little time. I would be glad to have that done during the recess. For the purposes of this statement only the average figure was worked out to the net investment after amortization. A proper relative calculation to what was done on the Company's books would have to be on the gross value of the assets. For instance, if the books - it sets up a gross book value. Therefore I say this calculation of amortization which I am asked to make must be relative to the depreciation provisions which the Company was making on its books.

Q MR. COMMISSIONER LIPSETT: Would you like to give us any explanation of why when you come to make out these accounts you adopted first a different system for depreciation and amortization than the Company themselves adopted, and secondly why you adopted a still different system to what was established in the earlier statements, namely that this should be all amortized in two or three years, if the life of the field should expire then?

A I formed my own opinion as to the period over which this capital should be brought back, having regard to the

risks. I was not satisfied until this calculation was worked out, because the calculation shows 10 years from January 1st, 1936. Although I knew some capital had been in this venture back in 1925. It was not until the calculation was worked out which brought a figure of about 13 years, that I considered a reasonable period in which the capital should come back, having regard to the hazards. I may say, Mr. Commissioner, I intend to discuss these statements going back over my report and supplementing what is in there in regard to the rate of return, the rate of income and the return and amortization.

Q I am wondering why you take 10 years for capital that is taken in in 1936 and 1937, why you did not adopt that principle before 1936, when presumably the field was not so well developed as now. Have you any reason in your mind for that?

A The reason I had in mind is that here we come to 1936 and there are some signs that there is going to be production, probably considerable production, and that the capital should come back to us, assuming 10 years of that production from this new field. That is what guided me in taking the 10 years. It seemed to me now that production was in a way sure, and the Company having just trebled its investment that it should be looking to the length of time over which it should get its money back. That is the thing that guided me in choosing that 10 years.

Q Do you not feel that that principle at least should have been adopted for the earlier years when the risk

was very much greater?

A The capital invested in the earlier years was very very much smaller. The real capital went into this Company in 1937 and 1938, and having that in mind, this large investment, just made, and putting a business judgment to it, that we should get that capital back in 10 years from 1936, seemed to me a reasonable time. Without having any regard at all as to whether the field would last that long or not. It is the point that my capital is there at a risk, and a considerable risk, and I get it back in 10 years.

Q How do you expect to get it back if Dr. Link's estimate of 2 or 3 years was correct?

MR. NOLAN: May I interrupt to say I do not think the record supports that time, Mr. Commissioner. What Dr. Link said was that there were three years sure supply, but that he did not have the experience to estimate the reserves on the unproven area, but that there was probably oil there, and that he would not condemn it. Then further evidence was brought in through other witnesses, through my Company and by my friend, Mr. Deussen who gave an estimate in respect of that unproven area. I do not think it can be said we have gone on record in this case as having limited the life of this field to 3 years, because that is not what Dr. Link intended to convey. I thought that was cleared up by the Chairman when he put that specific question to Dr. Link when he was in the box on the last occasion

upon which he appeared before the Commission.

MR. COMMISSIONER LIPSETT: I quite accept what you say. But that again is subject to the other qualification that it would only produce in any event 17,000 barrels an acre and no one would drill on that basis, at least the Royalite would not drill on that basis. However, that is rather a side matter. I was trying to get the reason for fixing this particular period from now on, only from 1936, and why not adopt it in the earlier period when the field was not proven anything like to the extent it is now?

A That is what I did, Mr. Commissioner. I wish to put this on record too, that this calculation, this period of 10 years to 1946, was chosen before I ever arrived in Calgary. I awaited the working out of the calculation, and it worked out to a basis of 13 years and I applied my judgment to that and I considered that was a reasonable time in which the capital should come back. And that is what the average, the average time that we find that the capital was returned.

Q For this period, but for the earlier period, that is not in fact, Mr. Taylor, the system that you have adopted at all. You did not take this 10 year period from 1925 on?

A No, but the average works out at 13 years. At more than 10 years. If I may, Mr. Commissioner.....

Q Please do not let me stop you at all?

A I have a calculation here which I think is interesting in that regard. This statement is referred to as Balance December 31, 1925, and Yearly Additions, showing

calculations of Weighted Average Number of Years during which Investment was employed on basis of Amortizing Capital completely by December 31, 1946. And that is the calculation out of which emerges this 13.171 years.

STATEMENT IN QUESTION IS NOW MARKED EXHIBIT "109".

Q MR. NOLAN: Now would you be good enough to address yourself to Exhibit "109" and explain to the Commission what it is please?

A I think, Mr. Commissioner, this is some information that you have been asking for at different times, showing the years in which the investment was made in these pipe line companies' assets. This statement is described as. - well I have just described it.

Q THE CHAIRMAN: Are these all the capital investments that were made in these respective years?

A On the basis which we have used in our calculation. The main feature of which is that we have brought into the capital assets the 6 inch loop which was put in in '29 and taken out in 1932. That is in this calculation.

Q MR. NOLAN: It is not in Mr. Morrison's?

A No, it is not in Mr. Morrison's.

Q But apart from that?

A Apart from that this would be exactly in agreement.

Q What does it indicate. The amount of capital invested in the utility assets and direct assets in each of these years?

A Yes sir, that is right.

Q In money?

A In money. Except for this, this percentage of utility assets.....

Q Yes?

A I was in error in saying we were exactly in agreement because this percentage of utility assets varies from Harvey & Morrison in respect of the rates of overhead that they have applied.

Q You have used a higher percentage on the utility assets than Mr. Morrison?

A Yes.

Q And there will be a variation in Column 1. But as far as direct assets are concerned in the second column, with the exception of the 6 inch loop, the answer is the same.

A And certain other items in the same category but in much smaller dimensions than the 6 inch loop.

Q Taking this percentage of utility assets, that is what you, in your judgment, say has been invested in the utilities in each of these years?

A That arises out of the calculation of the percentage of spread of indirect cost.

Q The total for the period, the entire period, is $121,024.57?

A That is right.

Q Why are these figures shown in red in 1933 and 1934?

A Those are the years in which there were reductions in the amount of fixed assets.

J. W. Taylor.

Q What does that mean?

A That through retirements, the retirements were in excess of the new additions.

Q And that is true of all the red items throughout the whole of this statement?

A Yes.

Q Then you have a total of direct assets of $1,465,150.56?

A Yes sir.

Q And a grand total of $1,586,175,13?

A Yes sir.

Q What is a weighted average? Weighted average number of years, what does that mean?

A Weighted average gives consideration to both money values and time. Both these elements are given effect to in the working out of this calculation.

Q That first item of 1925, $160,000.00

A Yes.

Q That is in for 21 years?

A Yes, 21 years, to December 31st, 1946.

Q The next item is in for 20-1/2 years?

A Yes.

Q And so on down, and then your weighted average is what?

A 13.171 years.

Q You arrived at that by taking the equivalent for one year?

A Yes.

Q You take the equivalent for one year and how do you arrive at that first figure in the last column, $3,368,185.17?

A By multiplying $160,389.77 by 21 years.

Q Yes?

A That gives $3,368,185.00. By bringing it to the basis of $1.00 for one year.

Q You multiply in each instance the total by the number of years, and that gives you a grand total of $20,890,870.82?

A Yes sir.

Q And then divide that by the total of the invested capital?

A Yes sir.

Q And you get as your answer a period of years, 13.171?

A That is correct.

Q And that is the average number of years during which the investment in this undertaking was employed?

A Yes sir, taking December 31, 1946 as the expiring date.

Q Yes, based upon that, it is the weighted average number of years during which the investment was employed.

A On the basis?

Q On the basis of December 31, 1946.

A Yes. Which is, on the calculation 8.58 years from 1938. I think I should at this time tie this figure to $1,465,150.00 direct assets, to the gross investment in fixed assets shown on Exhibit "A". If we look at the last figure on Exhibit "A".

Q On Exhibit "A"?

A The last figure on the right hand side.

Q Under the heading September 30th, 1938?

A Yes. The figure is $1,227,320.41.

THE CHAIRMAN: I do not see that, Mr.

Nolan. Exhibit "A"?

MR. NOLAN: On the top right hand corner of Exhibit "A". You will see the period September 30th, 1938. Under that figure is $1,227,320.41. What is that figure?

A That is the figure on which the capital investment is calculated which includes only half the additions for the year 1938. If we add one-half of the additions for the year 1938, we get a figure of $237,830.15, which brings us to the figure of $1,465,150.56, shown as direct assets on this statement which we have here.

Q What you are saying, Mr. Taylor, is that on Exhibit "109" your total direct assets in the amount of $1,465,150.56 can be reconciled with the figure of $1,227,320.41 on Exhibit "A" of Exhibit "100", by adding to the latter figure one-half of the capital invested in the year 1938, in the sum of $237,830.15?

A Yes sir.

Q That is your explanation?

A Yes sir.

Q And that is what you are saying you are tying it in with?

A Yes sir.

Q Now, have you said all you want to say about Exhibit "109"?

A Yes.

Q Now, then, let us turn our attention to Exhibit A of Exhibit "100" and, perhaps, you will be good enough to explain that to the Commissioners.

Q MAJOR LIPSETT: Before we pass from this Exhibit "109", Mr. Taylor?

A Yes.

Q You took this collection of direct assets, the whole capital put into this concern in 1925 was $152,000.00?

A Yes.

Q MR. NOLAN: Well, now, is that just right?

A Yes, that is quite right.

Q The whole of the capital put in in the year 1925?

A Plus, that is the whole, into the direct assets.

Q Yes, but you have added to it a percentage of utility assets, giving a total of $160,000.00.

A Yes, $160,000.00 is the total figure which went in in 1925.

Q MAJOR LIPSETT: And down to the end of 1935 it was something like $500,000.00 net?

A If we take the last three figures from the total, it works out at about $630,000.00, I think that may be the easiest way to get at it on account of all these red figures, if you take the total $1,586,175.13 and deduct from it $958,000.00,which is the total investment in 1936, 1937 and 1938, we get a figure of approximately $630,000.00.

Q Is it $630,000.00?

A About $630,000.00 I think.

Q MR. NOLAN: Yes, it would be, Mr. Commissioner,

about $630,000.00.

Q MAJOR LIPSETT: You take the last three figures, you say?

A From the $1,586,000.00, the figures of the last three.

Q I see. I was not dealing with the percentage of utilities?

A Yes.

Q Now, during those years between 1935, say 1935, was there any actual new moneys, apart from profits, that was put up by the company over and above this $160,000.00, do you know?

A I have not made any calculation of that, sir.

Q MR. NOLAN: Well, now, turning to Exhibit A, Mr. Taylor, you were going to tell us what that statement was intended to reflect?

A This statement, as the total indicates, is a statement of investments, showing date of return thereon for the seven fiscal years ended December 31st, 1937, and for the nine months ended September 30th, 1938. These headings across the top show the various periods from December 31st, 1931, to September 30th, 1938. The statement is, the first figure represents the investment in trunk lines, gathering lines and other direct capital assets, which has just been agreed with this Exhibit No. "109", which has just been submitted, showing the amount of the investments year by year back to 1935.

Q To what year?

A I beg your pardon, 1925.

Q Yes?

A 1925, and the figures December 31st, 1931, the first figures we strike is the investment in trunk lines, gathering lines and other direct capital assets, represent the accumulated amount to December 31st, 1931,

and carrying along the top of the sheet December 31st, 1932, shows the different balance, which takes cognizance of the change during the year and so on, December 31st, 1933, 1934, 1935, 1936, 1937, arriving at September 30th, 1938, of an amount of $1,227,320.41, which is reconciled with the investment year by year as shown in Exhibit "109".

Q In direct capital assets?

A In direct capital assets.

Q Yes. Now, what you are saying.......

A The second figure is the proportion of investment in utilities assets and service units applicable to the pipeline department allocated on a direct operating basis. Now, this amount is arrived at by taking the total investment in utility assets and applying to it the percentages which are arrived at in Exhibits C1 to C8. Perhaps, I might call off these percentages, Mr. Nolan.

Q All right?

A The percentage applied in 1931 is 10.3912%.

Q 1932?

A 1932, 11.5758%; 1933, 9.7317%; 1934, 10.9094%; 1935, 10.9903%; 1936, 12.6593%; 1937, 15.6018%, and nine months ended September 30th, 1938, 28.9996%. Those percentages are added year by year, those percentages of the utility assets are taken year by year and constitute the figure, the figure across the column, the second line of figures across the column.

Q Yes?

A Taking into account one-half of the additions for the current year, that is the total for the previous year, and one-half of the additions for the current year. That gives us our total investment in capital assets,

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amounting to:, 1931, $739,340.69; in 1932, $701,401.83; at December 31st, 1933, $635,691.56; December 31st, 1934, $633,535.22; December 31st, 1935, $634,564.01; December 31st, 1936, $681,151.58; December 31st, 1937, $951,327.33; September 30th, 1938, $1,551,573.26.

Q Then you proceed to set out your revenues for amortization?

A We set our reserves for amortization, all on the basis of return of the capital, whatever time invested, by December 31st, 1946, and those calculations give the amount of amortization, not the amount but the accumulated balance of amortization over the period of seven years and nine months ended September 30th, 1938.

Q Yes, and you take that away?

A We take that from the total investment in capital assets, that is the gross investment, and we arrive at a net investment in capital assets right across the page, and averaging $527,210.78.

Q Now, that averages for the seven fiscal years only, is it not?

A No, that is for the eight periods.

Q Yes?

A That figure is divided by eight because it is the investment that at a specific time, or that you have eight specific times'investment, and you divide it by eight to get the average.

Q Yes?

A The next column shows the allowance for working capital, which I deal with in my report, as $75,000.00 for each of the five years ended December 31st, 1935; $100,000.00 for the year ended December 31st, 1936, and $150,000.00 for each of the periods December 31st, 1937, and September

30th, 1938, giving an average of $96,875.00.

Q Yes?

A Adding that to the investment in capital assets we get the total investment along the line, with a double line underneath it, $1,148,378.79.

Q Yes. Now, your next item is "Net Profits"?

A Yes, that is shown on Exhibits C1 to C8. Those are the actual net profits as shown, taken from these statements, and they agree exactly with the figure of net profit shown in C1 to C8.

Q Yes?

A Then the rate of return is calculated in the relationship, if we take December 31st, 1931, net profits of $51,102.20 is 7.60% on the total investment of $672,087.90, the same relationship applies along these last two lines.

Q Yes, and that gives you what you call "The rate of return"?

A That is the rate of return on the investment on the basis of the profits as shown on Exhibits C1 to C8.

Q Yes?

A Then it has to be noted that the percentage works out, on the nine months, is 32.11, if you will look, Mr. Commissioners, at the last column, the percentage which has the red cross against it.

Q That is that 32.11?

A That 32.11, that is the profit, the actual profit, measured against the capital for this nine months' period, so we call attention to that and say in the foot note relating to that that "The above rate of return of 32.11% for the nine months ended September 30th, 1938, is equivalent to 42.81% per annum, assuming these nine

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months to be representative of the completed year 1938.",
which is the representation which I understand, which I
know, the company gave their agreement, that the nine
months was representative of the completed year 1938.

Q Yes. So you make a calculation on the basis of twelve
months to show the rate of return for the year 1938?

A Yes.

Q That is what you have done?

A Yes.

Q Now, that concludes the statements contained in this
report, Mr. Taylor?

A Yes.

Q Have you anything you want to add to these statements?

A No, sir, I think with the explanation which I have
given of them they speak for themselves.

Q I notice that you average the rate of return too, Mr.
Taylor, I do not know that you drew the Commissioners'
attention to that, on statement A?

A Yes, that is so. Taking this period of seven fiscal
years ended December 31st, 1937, and the nine months
ended September 30th, 1938, we find that the average
annual profit was $148,528.87, and that the average
capital employed was $624,080.78, giving a rate of
return of 23.80%.

Q Now, in arriving at that average did you use for the
year 1938 the figure 32.11% or 42.81%, or do you remember?

A The effect of our calculation was to take in the, 42.81%.

Q All right?

A Because we take the total and divide it by seven and
three-quarter years.

Q All right, and that is all you want to say about your

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statement?

A Yes.

Q Now, there is just one question I want to put to you, Mr. Taylor, of a general character, something has come up in the discussion here about the difficulty that arises now in distributing direct costs by reason of the fact that we have departmentalized this operation; in other words, we have several departments under the one company?

A Yes.

Q And it has been suggested it might be advantageous to have the pipeline company as a separate entity, a separate legal entity. Now, of course, we can all see at a glance that that would be of an advantage from the accounting point of view, would it not?

A Naturally so.

Q Naturally so?

A Very much so.

Q Very, very much so, but what about from the point of view of economy of operation?

A I think a separate corporate existence for the pipeline company would be more expensive, and the one thing which would arise there, that some basis of charging out tools, etc., to the company would have to be arrived at for all these indirect costs which we have had all the trouble about, and the question is as to what those charges should be, on what basis. For instance, the forge and machine shop, which work on all the departments at present, as to whether it should take a profit and charge it to the pipeline company as it would be then, and there are a number of different situations which

[illegible]

[illegible]

[illegible]

would have to be worked out.

Q All right?

A Under that.

Q But they could be worked out?

A Yes, they could be worked out.

Q But my point is that the Commissioners are interested in a discussion of it from that angle. Now, those utitities, for example, which are jointly used, some figure would have to be set up for them, would it not?

A As to.....

Q As to the distribution?

A As to the distribution of the expense.

Q Yes?

A Yes, some basis would have to be arrived at.

Q Are you prepared to say, when a company such as this, keeps its books such as this one does and uses utilities common to several departments, that that makes for economy in operation?

A Yes, I would unreservedly say that if this, if a separate pipeline company had to make an investment in its own utilities, that it would be a very considerable, it would be in a very considerable amount, to get the services as they get now through operating as a department of the Royalite Oil Company.

Q Yes. Mr. Taylor, have you some other statements which you want to produce to-day?

A Yes.

Q Will you explain to us just what they are?

A Unless you have any questions to ask in connection with the statements, I should like to go back over my report and

supplement what is in there at various points with some further considerations which I took into account in the summarizing of my views at the end of the report.

Q Now, do these form calculations which you have made, new calculations?

A No, not new calculations. Just rather an explanation of the manner in which I arrived at certain opinions which are expressed in the report as to the rate of return on capital and so on.

Q THE CHAIRMAN: Before you go into that, do I understand this, Mr. Taylor, that every figure which you present to us has been affected by your acceptance of the period of the, a safety period of 13.171 years?

A That is it.

Q For amortization?

A Entirely.

Q And you say that that particular period has been selected by you because it is in your judgment sound, and that it should be so selected?

A Yes.

Q And do I understand aright that in arriving at that figure you did not have regard to the life of the field?

A No regard to the life of the field, sir.

Q And that you did not have regard to the condition of the assets at the expiration of the thirteen year period?

A That is right, sir.

Q And that you have allowed for, have allowed for capital invested, to keep it in perfect condition?

A That is presumably taken care of in the operating expenses as we go along from year to year.

Q Yes, so that you have a line which is kept good, will be

presumably in perfect condition at the end of your thirteen years?

A Yes, that is so.

Q And you allow nothing for it at the expiration of that time?

A No, sir, because the business is such that we should get, that the capital should come back in this period.

Q That is to say, if you have the money invested and the capital back, and you would have a line with an allowance to keep it in perfect condition?

A Yes.

Q All right, I just wanted to understand it?

A But the position is that, and the calculations take consideration of the risk under which the capital is invested in the investment.

Q What risk is there, outside of the life of the field, which you did not take into account at all, if you keep the pipeline in a perfect condition, what risk is there about it other than there is no oil to go through it?

A That is the principal risk.

Q That there may be no oil?

A That there may be no oil to go through it after this, after 1946.

Q Are you not concerned then with the life of the field in determining whether or not there will be oil to go through it, I mean how otherwise can you come to any conclusion? There might not be any oil in one year, and there might be oil in thirty years?

A That is what I seek to do in averaging the situation for ten years.

Q You seek to do what?

A Average the risk of there being one year, two years,

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three years, or four years.

Q Well, then, does it mean this, that you have done your best to estimate the life of the field with safety from a financial viewpoint?

A Yes.

Q Are you competent to estimate the life of the field?

A I did not consider it an estimate of the life of the field, as I point out in my report, sir, but rather a business man's view as to how soon I should get my capital back.

Q Would you not be unjust to your client if there was no oil to go through this line in two years, you are not going to pay it for an average of thirteen years?

A I consider that in that period and in the period of years over which my capital is in that venture, having regard to the hazards which I would like to speak of later, the hazards which I took into consideration that, without considering the life of the field but just considering the hazards involved in the investment, that the period of thirteen years, which just works out as not an unreasonable period over which my capital should come back, using business judgment to the situation.

Q Now, you take, for example, 1946, you pick on that period that it should be paid out?

A Yes.

Q What leads you to think there will be no oil going through that pipeline in 1944?

A As I say, my Lord, I have used my business judgment in averaging the risk, so that the average of thirteen years reflects, strikes an average of time for which I feel that my capital should be returned in this investment at that risk.

Q THE CHAIRMAN: I understand it perfectly, that you say as a general principle, where I have a hazardous investment I want my capital back within a reasonable time?

A Yes.

Q The time within which you would want it back would depend on the degree of the hazard would it not?

A That is it entirely.

Q So you fix on the year 1946 as the last year out of which the capital should be returned. You must have an opinion that oil will be going through that pipe line until 1946, haven't you?

A No. The hazard is that,- the hazard is I might not have oil going through it up to 1946. If the hazard turns out to be not so serious as you calculated, if you come to 1946 and there is still oil coming through the pipe line, you have made a bad guess on that hazard. By the same token there may not be any oil to come through the pipe line after 1943, and I say that in this period the risk is average over, there being oil for some years after 1946 and the hazard of there being no oil some years before 1946.

Q You prefer to make a guess as to the risk involved?

A Entirely, sir.

Q Rather than listen to these geologists and their estimates of the life of the field?

A That is entirely so.

Q Well one more thing, Mr. Taylor. Have you considered where you would be at if, during the period of - well put it this way - supposing you had carried on with the depreciation on the basis of 10% annually,

as the Company did inits books?

A Yes.

Q Where that would lead you to, if you wanted the pay out in 1946. What bearing and effect it would have on the figures you have introduced to our notice?

A I believe that figure would emerge from the calculation that Major Lipsett asked me to make. If we take the rate, a percentage on the gross value of the fixed assets, which is represented by this total of amortization that will be set up in this period, I believe that would give the relationship. It would give the percentage which I think would be comparable with 10% per annum.

Q You see what I am getting at is, taking your idea of amortization and distinguishing between it and depreciation as you do - and it seems to be one entertained by other accountants as well - but I am curious to know supposing that a Company had gone on depreciating at 10% every year of the capital investment, just as it did in the books, audited by your firm, from year to year, and approved of, I suppose, and Incomes Taxes paid thereon on the basis of depreciation of 10%, correct?

A Yes sir.

Q To all Governments that impose an Income Tax?

A Yes sir.

Q Now supposing that were carried - and in that respect I daresay you are not different from other companies - but supposing that were carried right through to the bitter end and we forget about this difference of amortization and depreciation?

A Yes?

Q The fact is that within 10 years from any capital investment it would be paid out would it not?

A Yes sir.

Q I am curious to know where that would lead us. Where would we end up?

A I think the relationship is, my Lord, that your pay-off period would be this 13,171 years as against 10.

Q That is what I would like to know. I would like to know just exactly where, in figures, we would be at if we said "Well there is no difference between amortization and depreciation," and since you are not concerned with the additions of the assets at the end of the period, nor with the life of the field, I do not see why it makes the slightest difference, whether you designate it as amortization or depreciation. Therefore, I want to understand why you made a change in the system of approach to the problem and secondly, what the difference is, if any, if it were proceeded with in the way in which the Company started and of which you apparently approved. So if it can be convenient to deal with that I would be very glad?

A Yes, I will do that.

Q Now there is another matter. This Commission has no curiousity, at least not an unfriendly one, and while we have here heard from the accountants who have thus far spoken, that we should not be considering what has been termed excess profit, or profits, I do not know if the word "excess" is a happy one,

MR. NOLAN: Past profits, my Lord.

J. W. Taylor.

Q THE CHAIRMAN: Yes? Or we are not.
As to whether or not a rate fixing body is entitled to in any way have regard to profits and losses in the years that are past, that is by no means entirely settled. So I venture to ask you to find out if you will, and if you can, as to whether or not this pipe line department has put up any money other than out of profits, other than the original $160,389.37, and, if so, how much. Now in the end that may not have any bearing. We may come to the conclusion that the viewpoint thus far advanced by the accountants is the view that should be accepted by a rate making body. I merely want to have the data in case we come to a different opinion in the end.

A Yes. I believe, my Lord, Mr. Burns is making some calculation taking the situation back from 1931 to 1925. I do not know whether he is going to be able to speak as to the amount of profit, but I know he has a calculation. To go back to 1925 and go into this detailed accounting of splitting up this, it would be an impossible task. But I believe Mr. Burns will speak as to the period from 1931 back to 1925, along those lines.

Q It should not be very difficult, should it, or should it?

A It took two firms of accountants some months to deal with these four and a half years or four years and nine months we are dealing with now. As a matter of fact, prior to 1931 the records are not nearly in such good condition as they were from 1931 onwards.

Q I do not want any detailed figuration. I merely

want to know, the Company put up, from some source, perhaps the sale of stock, but I care not, anyway the Company put up 160,000.00 odd dollars in 1925. Now I want to know if from any source, other than profits, they have put up any other moneys since which has gone into capital investment. That should not take a lot of accountancy I would not think. Sources outside of profit. It may be of no importance, and if so I shall be sorry to put you to this trouble, if it is not, but I want something here on the record.

A I am afraid I would not undertake to speak of any period prior to 1931 without the same laborious detail as has been gone through to produce these statements. I do not know whether Mr. Burns will be able to speak as to the amounts of profit or losses prior to 1931. I would not undertake to make any calculation or estimate without going through the same very laborious manoeuvres as we have to produce the statement for the four years and nine months.

Q MR. COMMISSIONER LIPSETT: If you take your own Exhibit "109", Mr. Taylor, on this?

A Yes sir.

Q In addition to the $160,000.00 that my Lord has mentioned to you, you give figures in the following year, added in?

A Yes sir.

Q As capital?

A Yes sir, that is right. Year by year.

Q Does not the whole Inquiry you would have to undertake come down to this, are these figures new money put in by the Company or are they profits ploughed back?

J. W. Taylor.

A That is the calculation and the missing factor is the amount of the profit, which I would not undertake to place any estimate on, prior to 1931.

Q If there were not any profits, there would be payments in from some other department into this fund?

A Yes. The capital was found from somewhere.

Q The first figure you give, starting with that $160,000.00, the first figure you give is in 1931, and that figure from some source has become $672,087.90?

A By 1935.

Q No, by 1931. That is taking your figure in Exhibit "A"?

A Yes sir, that is the accumulated figure in the direct assets as it stood at December 31st, 1931.

Q Yes. If there was no new money put in, Mr. Taylor, - and here is frankly what is in my mind also - if there was no new money put in other than profit, that $160,000.00 put in in 1925 has become $672,000.00 in 1931?

A If the profits amounted to the difference between $160,000.00 and $632,000.00 that would be the case.

Q Or in the alternative?

A Or if the profits were not there the money was spent and the capital came from somewhere, there is no doubt about that.

Q It equally follows, if there was no new money put in from any outside source it must have come from the Pipe Line?

A Yes, If there was no new money. The only occasion for new money would be if there were not enough profits made to plough back into the business. That also depends on the assumption your method of accounting is correct?

Q In fact, if no new money was put in, this $160,000.00

must have been built up by 1931 to $672,000.00 out of the resources of the Pipe LineDepaetment ?

A There would be no means to discover the position there as to whether new money came in or whether this $600,000.00, or the difference between the $160,000.00 and the $630,000.00 came out of profit, no other way than determining the amount of profits in those 6 years.

Q THE CHAIRMAN: Perhaps you would not, as the auditor, but would not the persons in charge of the books know whether they get money from outside sources or not?

A That would not emerge. The financing of this Company is not divided into departments, and all we know is that the money went into the Pipe Line Department. As to where it came from in the set-up of the Company as a whole no one could tell. The money was found. The Company found the money and put it into the pipe line. There is no question about that. They spent it. There it is sitting in the accounts. As to whether they had enough profits to meet that or not I would be unable to say without a complete examination of the books as we did from 1931 onwards. It may be, my Lord, that after Mr. Burns gives his testimony in regard to the period prior to 1931, the situation may be clearer.

Q Yes.

MR. NOLAN: It will not be any clearer, my Lord, because we will be faced again - I must say we will do it gladly - but on what basis do we distribute the indirect costs for these periods?

MR. COMMISSIONER LIPSETT: On their own basis. Taking

their own figures. The only question I am asking you is whether this capital that was built up between 1925 and 1931, from $160,000.00 to $672,000.00; whether any of that money that was put in was new money from outside sources or whether it was built up in some way from the internal resources.

MR. NOLAN: In a word, did it come out of profits?

MR. COMMISSIONER LIPSETT: Or is there an inaccuracy in this statement.

MR. NOLAN: The question of whether or not it came out of profits at least turns again upon the question of whether there were any profits, and that question turns on the precise method of accountancy you applied to this department of this large Company to ascertain what profits were or were not made for those early years. It is this problem we are now confronted with, in the early years. It is doing then what we are doing now, and that is the only way it can be done according to the evidence.

THE CHAIRMAN: We will see what Mr. Burns has to say.

MR. NOLAN: He will have to take some arbitrary basis, my Lord. All this is arbitrary, Mr. Morrison's and Mr. Taylor's. Mr. Burns will have to take some arbitrary basis as to these indirect operating costs and what distribution should be made of them, because the method applied might make all the difference between whether there was a loss or a profit. What your Lordship wants I know very well; did the

money that went back into this undertaking come out of the profits of the Company. That is simply did it or did it not?

THE CHAIRMAN: Which, according to the accountants who have spoken today probably would make no difference at all. That may be the view that we entirely accept. But in case we do not, we do not want to be in the dark, which is an advantage to the Company quite as much as anyone else. We should not be making any bad guesses against it any more than in its favour. So it would be of interest. In short, I am not too sure, as yet, Mr. Nolan, that the work of a rate fixing body is not to get the whole picture and do what seems fair and just under all the circumstances, and that perhaps a Company that has made enormous profits over a period of years - I am not speaking of your Company now - might not be in a different position from a Company that sustained losses over a period of years, and that might have some reflection in the rate fixed by a rate making body who are no chartered accountants not engineers, but by bringing such common sense as they have to bear upon a problem which affects the public as well as the operating company concerned.

MR. NOLAN: I appreciate that.

THE CHAIRMAN: Just from that point of view and without any idle curiosity about this, we want to have some idea so that if anything should ever turn upon it we will have something to work upon. I am sure you would like us to have that.

MR. NOLAN: I am not raising these difficulties because I do not approve of taking past profits

into account. That is no concern of mine. I am trying to serve the Commission. But I am trying to point out you have to do that for the years 1925 to 1931, what these gentlemen have been doing for the years from 1931 to 1938. You have to use some arbitrary method of distribution of indirect overhead costs, in order to arrive at whether or not there was a loss or a profit in a given year. That means doing this work as has been done, if I am permitted to use our basis, Take from the year 1931 to 1925. Am I right about this?

THE CHAIRMAN: I do not know why you should not use your own basis. Any one criticising that can use some other basis. I do not know why you should be asked to come forward with any other basis than the one your people think is the correct one.

MR.NOLAN: Well it can be done, and we can take this basis, let us call it Price, Waterhouse's basis, and apply it to the years 1925 to 1931 and produce statements. Now the question of time. What does that involve, Mr. Taylor?

A It involves, not the same amount of detail as this work involved, but it does involve a considerable time.

Q Can you give us an estimate of the time?

A I would not be able to give you an estmiate until I talked it over with our people who would be carrying out the work. I think possibly, after talking it over in the adjournment, I might be able to say when we resume.

Q THE CHAIRMAN: Then we will leave it at that for the present. You understand we are not seeking any detailed data. You in Exhibit "109" have

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said that there had been added to the investment each year so much money?

A Yes sir.

Q And we asked the simple question, you have said it is added to your capital investment, but where did it come from. However, you might discuss it with Mr. Burns.

A I will discuss it with Mr. Burns and with the people who will do the work and I will be able to give you an estimate of how long.

Q I am just wondering if this possibility I put forward might not well be considered and examined into by Counsel, not so much from the standpoint of the witness in the box, but from such material as may be found in which light is thrown upon the approach that is made by regulatory bodies. There must be a lot of literature upon this subject. Just as one would read other cases.

MR.NOLAN: There are cases.

THE CHAIRMAN: There are cases?

MR.NOLAN: Yes.

THE CHAIRMAN: All this would be helpful. We do not want to pursue a course which is universally declared to be wrong, if that declaration which has become universal is made by people in whom we would have confidence. In short, we would like assistance on the underlying basic principle of the theory on which such bodies work. For an accountant to say "Well if a regulatory body had exercised a power 10 years ago the position would be so and so, but because it did not that the public should suffer a difference in the rate, if it be against them, or the Company

should suffer, whichever the case may be, perhaps double, because of that circumstance, gives me some pause. We have no view - I would like to make that clear - but at this minute we are not prepared to say that we have made up our minds that the accountancy point of view presented by anyone here present as to this is necessarily sound. In the very book that I think was put in the other day, was it Nash.

MR. FRAWLEY: Nash was one, yes.

THE CHAIRMAN: I have got Nash that I borrowed somewhere. I observed with interest he says - I think it was Nash - that the function of a rate making body is rather that of a philosopher than a technician, which is an intereeting statement. At any rate I put the thought before you, Mr. Nolan, and you too, Mr. Frawley. We do not hope you will train us to be philosophers in the short time at your disposal. Nevertheless, you might throw some light on this in the diligent search that I know you apply into any problem that confronts you.

(At this stage the Hearing was adjourned until 2 P.M.)

....

JAMES WATT TAYLOR, having been recalled, continued examination by Mr. Nolan.

Q Now Mr. Taylor, you have been dealing with a period ending December 31st, 1946?

A Yes.

Q But you have made computations, because we were requested so to do by the Commission?

A Yes.

Q On other yearly bases, namely 5, 10, 15, 20, 25 and 30?

A Yes.

Q Have you that computation with you?

A Yes I have it here.

Q You will remember, Mr. Chairman, that we were invited to do this and we have done it.

A This is described "Royalite Oil Company, Limited, Pipeline Department, Statement of Investment Net Earnings, Rate of return and Costsper Barrel on various amortization bases", the amortization, as mentioned by Mr. Nolan, being 5, 10, 15, 20, 25 and 30 years.

MR. NOLAN: And that would be I think, Mr. Chairman, Exhibit "110" if it is acceptable?

THE CHAIRMAN: It is one document?

MR. NOLAN: Yes, covering separate periods.

WITNESS: I think that may clear up perhaps what was asked. This is the only calculation I have made.

(DOCUMENT PRODUCED HERE MARKED AS EXHIBIT "110").

WITNESS: If I may, my Lord, I would like to leave this for consideration later and continue with the present basis.

Q MR. NOLAN: All right, Mr. Taylor.

A Just before the adjournment you asked me to make a calculation as to the depreciation rate represented by the amount set aside for amortization on this basis, and the average in these calculations for the seven years and nine months ended September 30th, 1938, is 5.687%. Now that is the average up to September 30th, 1938 but the, from 1938 onwards I wish to point out in the first place that the amortization provided up to September 30th, 1938 does not give full effect to the heavy capital expenditures which were made during 1938 and that only one-half of them is taken into the capital. I have made a calculation of what the 1939 amortization amount will be, which gives effect to that feature, of taking full cognizance of the 1938 additions and also take cognisance of the budget for 1939 and the setting up of a one-half years amortization on that.

Q And has that been prepared in the forms of statement?

A Yes.

Q Have you copies available for the Commission?

A Yes, the title of the statement is "Estimated Provision for Amortization, Year 1939".

(STATEMENT PRODUCED HERE MARKED AS EXHIBIT "111").

WITNESS: And I would like to go over that statement if I may.

Q MR. NOLAN: Yes.

A This statement commences with the actual amount---

Q THE CHAIRMAN: That is Exhibit "111"?

MR. NOLAN: Yes, my Lord.

A This statement starts on the direct assets, the amount of amortization as taken from C8, that is for the nine months

ended September 30th, 1938, that is the exact amount set as the amount of amortization for that nine months. The next figure, in the capital assets there were some uncompleted construction on which we took no amortization but will do so in 1939, that is the figure before 39.95. The next figure then in 1939, we will have three months' amortization, which will be exactly 1/3 of the first amount of $72,429.52, which is for the nine months period only, we will have an additional three months, so we take 1/3 of $72,429.52, which amounts to $24,143.18.

Q Now that is for October, November and December, 1938?

A Well yes, that is putting it on a one year basis.

Q Yes, all right.

A Putting the nine months on a one year basis.

Q Yes, all right.

A Then we have provision of 1/17 on the 1938 additions. Now the 1938 additions speak as to only half of the amount of amortization in the nine months ended September 30th, 1938, we only take 1/2, but in 1932 we take the whole year---

Q In what year?

A In 1939 I meant, we take the years amortization which is $27,980.02.

Q Why do we take 1/17 as the 1938 additions?

A Well there was only, in the figures for the nine months ended September 30th, 1938, which is the figure of $72,429.52, we only take one-half of the 1938 additions.

Q That is right.

A Now in 1939 we must take the additional half of the 1938 additions.

Q Yes.

A Which gives us a figure of $27,980.02, and then the budget for the year 1939 is $260,000 on which one-half amortization will be taken in the year 1939 and which will amount to, or 1/15, taking to the period December 31st, 1946, will ive $17,333.33.

Q Why do we take this 1/17 and 1/15?

A Well that is the equivalent of the half year. If it was a full year it would be 1/8 but we take it for only a half a year which is 1/15, that is taking it by half years up to December 31st, 1946.

Q I am afraid I do not follow that, Mr. Taylor. Perhaps everybody else does but I do not. I can plainly see you have only taken into consideration heretofore a half of the 1938 additions?

A Yes.

Q Now you proceed to bring those 1938 additions to a yearly basis?

A Yes.

Q Why do you take 1/17 of it?

A Because there is 1/17 in the Exhibit C8, there is only 1/17 but in 1939 there will be 2/17's.

Q Excuse me, it is nine and a half years, is it?

A Nine and a half years.

Q Nine and a half-half years, eight and a half-half years?

A Eight and a half-half years.

Q I see that now?

A And the other is seven and a half-half years, that gives us 17.33333, which will create an addition to the 1939 amortization of $75,896.48, bringing it to $148,326.00, in respect of the direct assets. In respect of the indirect assets the amount of the amortization as taken in Exhibit C8 is $13,804.95,

[illegible] ,50.00, [illegible]

[illegible] ,000 or 500, [illegible]

[illegible] and which will amount to [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

and adding 1/3 to bring it to a completed year, 1/3 of the $13,804.95 is $4,601.65, plus 28.9996% of 1/17 of the 1938 additions, the $337.79, giving a total of $4,939.44, which also has to be added to the amount shown in Exhibit C8, making a total of $18,744.39, or a total on the direct assets and utility assets of $167,070.39.

Q Yes, now---

A Which compares with the total of $72,429.52, the first item and plus $13,804.95, so that those two figures together amounting to $167,070.39 will be the amortization charge for the year 1939 providing the budget of $260,000 is carried through.

Q Now as I understand you, you are making a comparison between what you call your provision for amortization in your statement C8?

A Yes.

Q In the total of $86,234.47?

A Yes.

Q And this figure for the year 1939?

A Yes.

Q Of $167,070.39?

A Yes.

Q Now what is your point in showing the spread between those two figures?

A Well the point is that we have a complete new calculation, to compare with the average of 5.687 which I first gave you when I resumed the stand and I have made a calculation now on the basis of the 1939 amortization against the gross capital assets, which gives a depreciation rate of 9.17%. Now that 9.17% will continue on from now until 1946, subject to this, that is the years past and new capital additions

are made, we will pick up the amortization on those additions, so that your 9.17% will be a growing percent because you will be amortizing the additions which you pick up over a lesser period or lesser period each year as we go along, until we reach 1946 when the additions made in that year would be required to be amortized within the year.

Q Yes I see. Now Mr. Taylor, you were mentioning this morning you wanted to return to the report, is this a convenient place to return to it?

A Yes, I think it would be. I think there is nothing more to talk of in these statements at the moment.

(Go to page 2778)

Q What is the first point you are going to discuss?

A I am going to discuss the question of capitalization of administrative costs and indirect costs.

Q Yes?

A I would like to refer to page 2718 of the testimony of yesterday.

Q Yes?

A When Mr. Commissioner Lipsett.......

Q You are reading from page 2718?

A 2718.

Q 2718 of the record. Yes. Then you were going to refer to.....

A The Exhibit being discussed at that time was Exhibit "104".

Q Exhibit "104" was the distribution of administration overhead and of the indirect expenses on a labour basis for the year 1938, nine months of that year?

A The nine months ending 30th September, 1938.

Q Yes?

A Reading from the record, "MAJOR LIPSETT: Before you pass on from this first one, Mr. Taylor, does that method of dividing it up mean that construction and drilling, this second item of capital expenditure, contributes nothing towards the service units or utilities?"

Q THE CHAIRMAN: What page? I cannot find that.

A Page 2717, I am sorry, sir.

Q MR. NOLAN: Page 2717 is the beginning?

A It is about the middle of the page.

"Q MAJOR LIPSETT: Before you pass on from this first one, Mr. Taylor, does that method of dividing it up mean that construction and drilling, this second item of capital expenditure, contributes nothing towards the service units or utilities?

A No, there is no distribution of capital expenditure to this amount of administrative overhead.

Q MR. NOLAN: This is only operating labour?

A Operating payrolls.

Q MAJOR LIPSETT: Yes, but the service units and utilities I suppose are used for all purposes, are they including new construction?

A They might be to some extent but the basis, my basis for not distributing administrative expenses to capital is that you have certain fixed charges in the way of administrative expenses, which are going to be incurred in any case, whether there is any capital expenditure going on or not. You might say it is the company's annual charge which the profit and loss account should bear and if in one year you have some capital expenditure and take away a portion of that and distribute it to capital expenditures, the expenditure being as I say a fixed charge, you might say, in amount, you are going to fluctuate your profits to my mind artificially. Assuming, let us take it this way, we have exactly the same amount of administrative expenses in two years, two following years. Now the amount of those administrative expenses will be the same in those two years---

Q MAJOR LIPSETT: You mean whether there are capital additions or not?

A Yes, whether there are capital additions or not, and supposing half your payroll is capital expenditure payroll, as seems to have been the case in this year from that statement, then your profit and loss account is artificially changed to the extent of half of the administrative expenses by the distribution to capital

expenditures, although had there been no capital expenditures the amount of those expenses would have been the same and the principle of not distributing it to capital expenditures, if those expenses had been increased through the capital expenditures, if those expenses had been increased in amount I would agree that some, whatever is represented by the increase which could be laid at the door of the capital expenditures, could be taken out and distributed to that capital expenditure.

Q MAJOR LIPSETT: You think that same principle applies, do you, to the service units used?

A Yes, there is a certain minimum fixed expenditure which we must make to keep our operations going. We are in the business of producing oil, and taking that oil over the pipeline, that is the business we are in and that business should stand its normal annual charge and should not be fluctuated back and forth as to whether or not you are making capital expenditures. My submission is that it gives you an artificial fluctuation on your operating results and from my observation, Mr. Commissioner, in the manner in which administrative expenses and these indirect expenses moved, having studied them over these four years, I find whether they are making capital expenditures or whether they are not, the amount actually spent under the heading of 'administrative' and under the heading of 'indirect' do not fluctuate at all. They certainly are not increased in years when capital expenditure has taken place."

That is what I wish to read into the record. I mentioned

having made a study of how these expenses move in relation to capital expenditure and I would like to submit a statement in this regard. It is described as Movement in Administrative and Indirect Costs and in Payrolls Chargeable to Capital Additions. It covers a period of four years and nine months ending September 30th, 1938.

Q MR. NOLAN: May we offer that as an Exhibit, Mr. Chairman?

(Document in question is now marked Exhibit "112".)

Q THE CHAIRMAN: This Exhibit "112" is called what?

A Movement in Administrative and Indirect Costs and in Payrolls Chargeable to Capital Additions. At this point I would like to refer to Mr. Morrison's report, so as we can follow these particular items and also certain other items to which I wish to refer. Statement No. 17 of Mr. Morrison's report.

Q MR. NOLAN: You mean page 17?

A Page 17, yes.

Q Yes?

A Which is for the year ending December 31st, 1937?

Q Yes?

A And the items listed on the last section of the page, I would like to go first to the items, the first red figure on this page. That is this.

Q Trucks and tractors?

A Take the item Trucks and Tractors, Company Garage, Water System, Forge and Machine Shop, Storehouse, and turning over the page, Residential Quarters, Employees' Garage, Now, stopping there. These are residual balances remaining in these accounts, the red figures representing

the profit, you might say, made on the charging out of jobs to, partly to operations and partly to capital. That is to say, that any work that is done on account of capital expenditure is charged out to capital expenditure and this balance is not the measure of the transactions that went through. There are debit and credit balances in very much larger amounts, which finally work down to this residual balance. Take in the case of the Forge and Machine Shop, for instance, it is very largely used in connection with drilling. All the expenditures, all the jobs done for drilling or any other capital expenditure work, has been charged out through that account. So that the capital additions have got their charges in respect of any capital items that had work done in these shops. There has been a distribution to capital expenditure on the jobs so applied.

Q And these figures represent what is left?

A What is left, the residual balances after taking all the charges, wages and material and so on, and clearing out the jobs on some unit basis, going to capital expenditure or operating, as the case may be. There are left certain items. Going now to the black items above there. Boiler Plant, Electric Plant, Turner Valley Office Expense, Engineering, Laboratory, and General Plant Expense, and so on. Perhaps, if we take the items that are now listed on this Exhibit, and we compare the amounts with 1937. Boiler Plant Expense, totalling this small figure under Taxes, to $25.529.69, we get $26,227.24. Electric Plant Expense, $24,218.96. Turner Valley Office Expense, $14,662.64, which is, $161.07 added to the $14,501.57. Engineering, $7,710.02; Laboratory, $12,512.94.

General Plant Expense, I believe General Plants Expense, sir, is one of these items which is allocated out by jobs, and it is a black balance. It finished up at a loss.

Q MR. FRAWLEY: Is it not your $9,187.31 at the bottom of your statement?

A Yes, that is correct. This has just got out of order. Yes, General Plant Expense, $9,187.31 General Tool Room Expense, $1,681.92. Fuel Gas Lines, $8,501.93. Now, we come to the items which we dealt with, which are distributed partly to capital expense. The Residential Quarters and the Employees' Garage are, I understand, distributed on a unit basis. Camp and Sanitation, Expense represents the complete expense for the year, $2,079.28 plus $6.85, equalling $2,086.13. Fire Equipment Expense, $4,087.19 plus $46.55, making a total of $4,133.74. Making a total for that year of those particular items of $110,922.83. Now, the point I wish to bring out in this Exhibit......

Q "112"?

A "112", is, I have listed these expenses year by year, similar expenses to the ones I have just read off for the years 1934, 1935, 1936, 1937, and 1938, taking in 1938 and adding one-third to the actual expenditures as they were for the nine months ending September 30th, 1938, to bring that to a yearly basis. That is, as to the utility expenses and service units. And above this you will find the amount of Administrative and General Expenses, year by year, and the two are added together under the description of Administrative and General Expenses and Utility Expenses and Service Units, the total for the year 1934,

the amount for the year 1935, the increase or decrease from the previous year. And then we take the total of this expense for the year 1936, amounting to $183,483.47, and percentage of increase or decrease from the previous year, which is 2.11%, and the amount of percentage increase for the year 1937, in which the particular item is noted, because it represented the artificial fluctuation of these expenses, in order to get a true reflection of the increase in the expense of the same nature. And then we have the amount for the year 1938 and the increase of 17.55 from the year before. Now, underneath we have listed the Payrolls Charged to capital expenditures for the years 1934, $72,479.05; for the year 1935, $188,975.86, or an increase in the capital payrolls of 160.73%. If one looks at the figure above one finds that the Administrative and General Expenses and Utility Expenses and Service Units, or overhead, let us call it from here on, which is so much easier, only increased by 10.94%. I take that as my indication that there was certainly no growth in these expenses in any way related to the growth in the capital expenditures for these years.

Q In other words, you are taking the capital expenditures year by year and you are showing the increase in percentage of one year over another?

A Yes, sir.

Q And you are doing the same thing with what you have just called your overhead expenses?

A Yes.

Q Showing the increase in percentages one year over the other?

A That is correct.

Q You have given us a figure of 160.73% of the Payrolls charged to Capital Expenditures as against 10.94% of overhead expense?

A Yes. And following along the percentage column we find in the year 1936 there was a decrease of 19.67% in the Payrolls charged to Capital Expenditure as against an increase of 2.11% in the overhead. Going to the year 1937 we find that the Capital Expenditure Payrolls increased by 93.46% whereas the normal increase in the administrative overhead, that is, ignoring the special item which caused an artificial increase, was 3.24 in the overhead as against 93.46 increase in the capital expenditure payrolls. In the year 1938 the increase in the Capital Expenditure Payrolls was 41.30 as against an increase of 17.55% in the overhead. In regard to that increase in 1938 that was the period when the pipeline was being stepped up to its 6,000,000 barrel capacity. Now, in studying these figures, I fail to see how any reflection of an increase in these overhead expenses is caused by capital expenditures, and that is the study I stated I had made, as to whether these expenses did or did not move in any relationship to the capital expenditures.

Q Yes, and you have shown us the capital expenditures and how they have increased or decreased?

A Yes.

Q And the corresponding rates of increase or decrease in the overhead expenses?

A Yes, sir.

Q Now, turning to your report, Mr. Taylor, you have some comments to make upon it?

A Yes.

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Q What, in the first place, do you want to consider?

A First, to consider the basis of my arriving at the investment in the capital assets.

Q And that would be at page 3 of your report?

A At page 3 of my report.

Q Under the heading "Investment in Capital Assets"?

A "Investment in Capital Assets".

Q Yes?

A I should like to read that paragraph, Mr. Nolan, if I may?

Q Yes?

A Page 3, "Investment in Capital Assets: The investment in capital assets shown on Exhibit A is arrived at on the basis of the dollar value put into the business year by year, less the dollar value recovered on the retirement of capital assets year by year. In applying this basis we have included in the capital assets the 6" Loop Line which was laid in 1929 at a cost of $178,885.02 and taken up in 1932, at which time a recovery value of $76,482.60 is credited to the Investment Account. The application of this "cash" basis also had the effect of adding $56,269.66 to the capital assets as shown by the books over the period from 1925 to 1938."

(Page 2787 follows.)

Q Now as I understand it, Mr. Morrison has not estimated what you call the "cash basis"?

A That is so, that is so and has given no cognisance to this capital expenditure which was made at this time. Now the manner in which I consider this, Mr. Chairman---

Q THE CHAIRMAN: Just what capital expenditures do you say Mr. Morrison has not taken into account?

A Not the $178,885.02 or the $56,269.66.

Q MR. NOLAN: The $178,885.02 is directly applicable to the 6-inch loop?

A Entirely applicable.

Q Yes.

A That was the cost.

Q But the $56,269.66?

A Has reference to items of like nature.

Q That came in and went out?

A That came in and went out and they disappeared from the books.

Q That is so. We will call them "Miscellaneous items" if we may?

A Yes, the principle is the same and I think it would be best for me to deal with the larger item.

Q All right.

A The 6-inch loop.

Q Which exemplifies what you are going to discuss with us?

A Exactly.

Q Yes.

A The manner in which I consider this, Mr. Chairman, was that here is an investment, cash money investment, made after due consideration and in the best judgment of the officials of this company as to this 6-inch loop being required. In this

business of laying trunk lines and gathering lines the company has always got to be, well shall I say "a jump ahead of the game" and this loop was constructed at a time when there had been an increase in the production of oil, which looked as if it might continue and if it did continue this additional facility was necessary in order to handle it. No doubt about the cash investment having been made and made in the best consideration of the officials of the company, you must assume that. The production did not materialize for reasons over which the company had no control. The oil did not come and after waiting for some three years to see if it would develop it was decided that they had better take the pipe up, that it was not going to be required, and following the proper practice in the books that investment was lifted out of the books, it should be there no longer. The investment for the purpose of the company's balance sheet would be wrong if that was not lifted out but from the point of view of the cash having been invested there is no doubt in my mind that the investment was made, the books show it was made and I dare say it would have been improper, as I say, to leave it on the books because you would not be showing the proper position of the company's assets, if you did not make the book's entry. I would like to draw a parallel with an oil company that drills a well and gets no production, dry hole, it has just sufficient capital to drill that one well, its capital is lost, it writes it off in its books, quite properly so, because the asset has no value and they write it off in its books. They decide to take another change and they raise new capital and they take another, drill another well---

[illegible]

Q They sell a few more shares?

A They sell a few more shares, raise more capital, enough to drill another well and it becomes a producer. Now I think it would be quite wrong to relate the earnings that come from the investment in the dry-hole and the investment in the producing well on only the capital invested for the second time in the well which was producing. I say the proper relation is the income against total investment and that is my submission as to the justice and the propriety of bringing this 6-inch loop back and taking, including it in the capital account at its whole cash value in the year in which the investment was made, that was in 1929 and giving credit in 1930 when the line was taken up at the cash value which it then had and for which it was given credit and for which it is given credit in these figures, that is you see, the original cost was $178,885.02, which was amortized over a period of three years. At the end of three years there was a cash recovery, that was the credit which was given on the books for the pipeline for the pipe when it was taken up in 1932, so that the amortization then from that point onward was on the difference between $178,885.02 and $76,482.60 until the end of the period.

Some days ago, Mr. Commissioner, you asked to have worked out the daily average revenue from that Exhibit "42" which was put in some time ago and you also pointed to the fact that in a certain period, two periods, about the middle of this tabulation, there was, there seemed to be a high production, a high daily production.

Q MAJOR LIPSETT: Revenue?

A Yes, the periods are from March 1st, 1927 to November 30th, 1938,

[illegible]

and perhaps I might put this in.

Q The question you are referring to was addressed to Mr. Morrison by Commissioner Lipsett?

A It was addressed to Mr. Morrison.

Q Is that your own calculation or is that made---

A No, it is the calculation arising from 42, which contains the average daily barrelage and the pipeline rate and Major Lipsett was anxious to see what the average daily income was.

Q The average daily income over the period?

A Yes.

Q And that has been prepared?

A And I would like to submit this now if I may.

Q If that may be accepted as Exhibit "113".

(STATEMENT PRODUCED BY THE WITNESS HERE MARKED AS EXHIBIT "113").

Q MAJOR LIPSETT: Daily gross revenue?

A Average daily revenue. I think it will be simpler to view it in the light, this statement is referring to his statement showing average daily revenue from pipelines, for the period from March 1, 1927 to November 30, 1938 and it takes from Exhibit "42"----

Q Now Exhibit "42" was an Exhibit put in showing the changes in the rate over the entire period in which the pipeline has been in use?

A And it showed also the average daily pumpings and before, this summary takes these average daily pumpings and applies the rate applicable to the charge and works out the average daily revenue and we have added, because it is interesting I think, the number of days over which that average daily revenue applied, which is at the extreme right-hand corner, and Major

Lipsett also referred to the two items which worked out at $901.50, the 4th and 5th items on this list, and asked whether this related to any particular capital expenditures and having regard to the date, the first date being May 1, 1929 to December 31, 1930 and from January 1, 1931 to February 10, 1931, to my mind there is a reflection there of the capital expenditure of the 6-inch loop which I have included in my investment account.

Q Well now from this period of May 1st, 1929 to December 31st, 1930, 610 days, the average daily revenue was $901.50?

A Yes.

Q For the next period being January 1st, 1931 to February 10th, 1931 a period of 41 days, the revenue was, average daily revenue was $1276.80?

A That is right.

Q At the same rate per barrel?

A At 30 cents per barrel.

Q Now what conclusion do you draw from that?

A The conclusion I draw from that is that this period followed the construction of the 6-inch loop which was put in in 1929 and taken out in 1932 and that may be, Major Lipsett's query was as to what caused the increase in the average daily barrels, was there any capital expenditure made to which that might relate and the dates coincide with the period when this 6-inch loop was in operation and I submit that that might be a reflection of that capital expenditure.

Q You mean of the apparent necessity of it?

A Of the apparent necessity for it.

Q At that time?

A At that time.

Q Having regard to the average daily pumping and to the average daily revenue which was being enjoyed in that period of May 1st, 1929 to December 31st, 1930?

A Yes.

Q I see what you mean.

Q MAJOR LIPSETT: Before you pass now from that, Mr. Taylor, the total amount during the time that these two high daily returns were in existence. that is from May 1st, 1929 to the 10th of February 1931?

A Yes, a period of almost 2 years?

Q A period of almost 2 years?

A Yes.

Q Have you the figure there, how much actual gross revenue that gave the company?

A Well I can work it out, 610 days of $901.50, would that not be the revenue, I make the figure about $550,000.

Q That was obtained apparently by raising the price of naphtha?

A That is just the 610, yes, the 610 days of $901.50, if it were a thousand dollars it would be $610,000, therefore it is around $550,000.

Q If you add the other period,---

A Supposing we take the other in at $400.00?

MR. NOLAN: Not in that period.

MAJOR LIPSETT: The $1276.86, and the 41 days?

A Yes.

MR. NOLAN: Approximately $50,000.

MR. FRAWLEY: $52,348.80

WITNESS: That is about $600,000 in the two periods.

MR. FRAWLEY: $602,000.

Q MAJOR LIPSETT: Now that was obtained, was it not, mainly by raising the transportation rate for naphtha from 5¢ to 30¢ during that period?

A Yes, that is the total revenue but the production, if you take, at the moment we, when this Exhibit was being considered there was nothing there but the dailing pumpings and your query had relation to the high average daily pumpings, so that the money value is perhaps not the measure but the barrelage is I would say the measure of the necessity for this investment.

Q MAJOR LIPSETT: But I would just like to continue putting it to you in my own way and I would like to know whether you think it is or not right, they expend it in this period, this loop line, assuming it was properly done and on good advice and everything else, they expend $158,000?

A Yes.

Q In that period?

A Yes.

Q And at the same time, whether it was to pay for that or not, that may be a matter for discussion but at the same time, during that period, they increased the transportation rate to give them $600,000 as against this, that is gross of course, but as against this capital outlay of $178,000?

A No, not the whole $600,000, sir, because that is assuming that all the 30¢ was additional revenue but there was a revenue, there was an increase of 25¢ so you cannot take that at 30¢, take it at 25¢, so we will have one-sixth off to show the actual increase?

Q Yes.

A That would bring it to about $500,000.

Q So taking the one-sixth off the $600,000?

[illegible]

A Yes.

Q Leaves?

A About half a million dollars.

Q Leaves the increased rate they put on?

A That comes from the increased rate.

Q So when they were making, take the period when they were making the capital investment of $178,000, they were actually getting back $500,000 extra in the two years' revenue?

A That relates to that period but I think one can only average such matters as that over a period of years. I think for instance when you come to 1937 and 1938 you find a very mcuh different picture from that.

(Go to No. 2795)

Q Well probably when you come there but at that particular moment, Mr. Taylor, this question of hazard or risky investment does not look very serious, does it?

A Back in that time?

Q On that particular period?

A Well I think the hazard is rather reflected there, I do not know the sitatuion as it was very well then but my information is that it looked as if there was going to be considerable additional oil production.

Q Yes.

A It didn't materialise.

Q Yes, but so far as money was concerned, is it not a fair inference or not, I will put it to you, to say that the company kept themselves so safe that they got $500,000 gross to meet a capital expenditure of $178,000?

A Well I do not know that this was the total expenditure, the $178,000 for this period, this was the expenditure for this 6-inch trunk line, I do not know what the additional expenditures now were on gathering and so, gathering lines.

Q So far as that expenditure is concerned it seems to have been got back out of current revenue, doesn't it?

A Yes, it seems to have, that seems to have, taking that small period of time by itself.

Q Now just to follow this up then, Mr. Taylor, you say then that $100,000 of that $178,000 was lost through nobody's fault, practically?

A Yes, that is right.

Q Now you say that we should carry it on into the capital structure as of today and base our rate on that $100,000?

A Yes, I say you should include that $100,000 from 1932 as representing cash money which was invested and was never gotten back, or cash money which was invested in 1929 and

as to the $175,000, and giving a value for the recovery in 1932.

Q And that entirely irrespective of this picture of the takings in the year?

A I do not think that is reflected in any way in this basis which I claim is the proper basis in regard to that 6-inch loop.

Q Am I right in thinking that you are going a little further than that, Mr. Taylor, in your structure and that in addition to recouping you for that loss, now in the capital structure that we should give you an income on it as a part of the investment?

A That all comes back to this question as to wehter the past profits are to be considered in the basis; I mean this figure of half a million dollars that we take off, having to be made in this period. Of course it was not all made because there would be the expenses as well.

Q Yes, that is gross?

A That is gross. That is all to my mind part of this whole question of whether or not half profits are to be taken in0 to consideration in establishing the rate.

Q Well I was just going to ask you as to that. I have no opinion on it myself at the moment, Mr. Taylor, but I would like to get everybody's opinion, you I suppose agree with the views we have got, that the past profit should not be considered at all?

A I consider that quite, sir.

Q Now what I want to put to you is this picture which you are giving to us now, are you not asking us to do, to apply the same principle in your favour where there is a loss?

A Well this is a capital loss, as I see it, it is not an operating loss at all, it is a capital loss which the company suffers.

Q Is that any real distinction in your opinion, because I notice in your figure, and I am putting this to you to get your answer, I notice in your figure, you put in capital gains or losses, you take them into the picture?

A Those are not gains or losses, you mean in that last statement?

Q The capital gains where you have written a thing down and you get more for it when you are wrriting it off your books?

A I do not follow you there.

Q Perhaps it is only argumentative, but you do reinstate the accounts, if there is a gain in the resale of some of the equipment or something like that, you reinstate that in the books?

A On capital assets.

Q Well, you take them in in the income for the year, don't you?

A No, I don't take, no, there is no such income in this pipe line. The only income we have in our statement is the transportation income and the income from the Pipe Line Adjustment, There is no income of the nature you speak of, capital income, in our statement.

Q What distinction do you draw in principle then, as between asking us to reinstate this loss, this past loss, this bygone loss as it is here, as distinct from our considering the picture as to whether or not there have been profits made?

A This is a cash investment.

Q Which turned out to be a bad one?

A Which turned out to be an investment which was not fully used.

Q And you think that that should be reinstated for the benefit

of the Company?

A Yes.

Q But that there should be no consideration made against them when they made an enormous profit or a large profit?

A The profit as I see it, the profit came from the rate that the Company was enjoying back in those years.

Q Well do you not think that it would be a fair subject for inquiry, to go a little further and inquire whether this $178,000.00 was a real capital outlay and a capital loss, or whether it was something that was incurred as it turned out, expended out of profits, and in which case merely reduced the profits for those particular years somewhat?

A Yes, that would be a reasonable inquiry.

Q I do not know if you have the figures as to whether there were actual net profits enough that year to do that whole work as indicated by the gross profits, or by the gross revenue?

A What period is that?

Q It is this period of 1929 you see, onwards.

A Well the first period we have is the year ending December 31st, 1931.

Q Well the first period when the rate was raised seems to have commenced on the 1st of May, 1929, Mr, Taylor, which is the time which you give when this $178,000.00 was expended?

A Yes, the figure, the only figure we have that would give any light on that is the profit for the year ending December 31st, 1931, which takes in all but a month and a half of the second period.

Q You want 1930 and 1931?

A We have not got 1930 but we have the year 1931.

Q You see this increased revenue, you had it for eight months of 1930?

A That is right, sir.

Q And apparently it started about the time that this 6 inch loop was built?

A That was eight months in 1929, sir, and then all of the year 1930.

Q That is correct?

A Yes.

Q Well now you see what I was lookingat, Mr. Taylor, and perhaps you would like to look into it and tell us something about it?

A Yes.

Q But what I was looking at in this was up to April 1929, the company's gross revenue was $162,000?

A Yes.

Q And that suddenly, that was jumped up to over $900 a day?

A Yes.

Q And afterwards to $1276 a day?

A Yes.

Q During the very period when these capital expenditures seemed to have been incurred.

A Yes.

Q And if you will look into it, perhaps you would look into the last two items when the new capital outlay was being incurred?

A The last two items, sir, you mean 1937 and 1938?

Q Yes.

A Well---

Q From September 1st, 1937 to 30th November 1938?

A Yes.

Q There again during a period of capital outlay the daily takings went up in the first period to $1664 and in the second one to $2472?

A Yes, well the position in that regard over this period of seven years and nine months is brought out in my report.

Q Yes?

A The average situation over that period and I perhaps, the capital expenditures during this period against the earnings of that particular year would give the picture you have in mind except that it would be difficult to get those showing for an odd period like from September 1st.

Q Yes.

A But you have---

Q You might be able to consider for us, Mr. Taylor, or get some information as to matters which I am trying to inquire about and one is the period 1929 and 1930, the other the period from the end of 1937 to-date, when large capital outlays were incurred, that on both of those occasions apparently the daily revenue of the company was put up?

A Yes.

Q To very much increased figures?

A Yes.

Q And what I am putting to you, if you will give it to us, whether that was done in order to pay the capital out of the daily income?

A Yes. What one could do, Major Lipsett, is to line up that situation year by year for 1938 and 1937, and show the relation between the new capital that went in and that possibly came out, is that the picture you have in mind?

Q It is only a line of inquiry, Mr. Taylor, but you see what is in my mind?

A Yes.

Q That possibly what was done was to increase the daily revenue so as to take care of the capital expenditures in that period?

A Well of course the daily revenue increased automotically as the larger production came in but what you would like me to do, sir, is if I can take a note of it so that we will know, is to assume a completed year 1938, we have the figures now and we are complete, with the last quarter of 1938 as representative, the nine months of 1938 as representative of the full year, if we take the full year's profit on the basis of the nine months by adding 1/3, that will give us our 1938 profit.

Q Yes.

A We take our 1938 capital addition and relate the one to the other, and do the same with 1937.

Q I would think that would give us what I was looking for, Mr. Taylor?

A And should we not bring, and forgetting what capital was put in and perhaps was not returned up to that date, you want the relationship for those two years between the profits for the year and the capital additions for the year, now which of those two years, 1937 or 1938?

Q Yes, and 1929 and 1930 when the earlier expenditure which we were dealing with was made?

A And in 1929 and 1930, I have not got 1930, I have not got 1929, and I have not got 1930 in my figures but I believe there will be an estimated profits for those back years coming in so that I would have to delay that calculation until those are available but the 1937 and 1938, I can submit to you tomorrow morning.

Q MR. NOLAN: You will do that?

A Yes.

(Go to page 2803)

[illegible]

[illegible]

[illegible]

Q MR. NOLAN: You will do that will you?

A Yes.

Q Now you have two more points to raise in your report that you would like to mention.

Q THE CHAIRMAN: Just on this one point, I appreciate your position throughout this discussion. You say that so much money is invested?

A Yes.

Q It is a capital investment and you are entitled to get your money back, and a profit on the whole if it is possible?

A Yes.

Q If you are unfortunate in making an investment in one respect that does not pay, it does not matter at all. You get no particular credit for making a happy investment and you should suffer no particular hardship because you make a bad one?

A That is right.

Q If you happen to lose $170,000.00, equally you use good judgment in other cases?

A Yes.

Q And it should be thought of as a whole investment, and your return and amortization should be on the whole of the capital investment?

A Yes sir.

Q Even if part is thrown away?

A Yes, and average the fortunate investments with the unfortunate ones, and bringing the unfortunate ones into the picture, so that we get the same off-set to average the fortunate ones.

Q It is like buying a horse to carry on your business

which happens to die. I must say I have some concern as to why that should be thrown out. I just wanted to be sure I had your position?

A That is exactly the view I take of it, Sir.

Q MR. NOLAN: You had two more points you wanted to raise in your report, Mr. Taylor. You have been dealing with what we call a cash basis of investment and capital assets. Now, Mr. Taylor, you had intended to draw the Commissioner's attention to two more points in your report, the first of which was - in what order are you taking them?

A I should like to......

Q THE CHAIRMAN: I wonder if I might bother you - excuse me, Mr. Nolan - assuming you are right in your view about this $178,000.00. You say it is the same for.....

A The $56,000.00.

Q The $56,000.00?

A It is in the same category.

Q It seems to one like myself that seems quite a sum. Just what are they? Are those listed anywhere?

A I have not got a list of them, but it is available in the office.

Q We are not curious, Mr. Frawley. I do not want to discuss the item of $56,000.00, but if we are going to take the $56,000.00 into account we want to be told what it is, and not just that they are in a category.

Q MR.NOLAN: You have amongst your working papers......

A Amongst my working papers there is a list.

Q Perhaps that should be brought in to show how that is

made up?

A Yes, I will do that.

MR. NOLAN: We have been a little general about that, haven't we. All right, Mr. Taylor?

A The only other point in this report that I would like to speak on is the rate of return on the investment which I took upon myself to calculate at 20%, having regard to the hazards involved. I should like to enumerate some of these hazards as I see them.

Q You are referring now to Page 4?

A I am referring to Page 4 of my Report. Under the heading "Rate of Return on Investments".

Q You stated it as your opinion, having regard to the hazards involved, the rate of income return per annum should be 20% on the investment?

A Yes sir, that is the paragraph I have reference to.

Q Now you have stated that it is your opinion, having regard to the hazards involved, that the rate of income return per annum should be 20% on the investment in this department?

A Yes.

Q I am reading that from Page 4 of your report. Is it your desire to enlarge that language to explain some of the hazards which you consider are involved?

A Yes sir.

Q Perhaps you will do that?

A One of the principal hazards, which is perhaps not so potent now as it was in the past days, but which may become so years from now, and perhaps not many years from

now, is this question of drilling through this 7,000 to 10,000 feet and finding no oil. In the case of most industrial concerns, commercial concerns, when one's capital becomes in jeopardy, it is very often saved by injecting a small amount of additional capital.

Q A refresher?

A A refresher as it were. But in the case of drilling for oil it is a case of a complete duplication of the investment. I think that is quite a hazard as compared with the commercial hazard where by injecting maybe 10% more additional capital one might save the whole. The money value or that feature of loss comes to my mind. There appeared in the surplus accounts of the Imperial Oil Limited, the Annual Report in 1934, an amount of $4,861,690.34 which was written off to their Surplus Account under the distribution of expenditures prior to January 1, 1934, and the explanation "Properties in Western Canada proved to be Non -productive of Oil." That is not all Turner Valley. I do not know which proportion, but it is a hazard in the oil business at any rate. The next hazard I see is the possibility of cheaper and shallower fields coming in. I think last night I read in the evening paper of a well coming in Lloydminster, that looks like it might be a well, at, I think, it was, 1,965 feet. There is also a risk of a competitive pipe line coming into operation from Turner Valley, and one of the biggest risks I see ....

Q THE CHAIRMAN: If we were to lower the rate it might be a deterrent to that?

A Yes.

MR. FRAWLEY: And 15 cent$\not{s}$ rate might bring a lot in?

A And again there might be a franchise. But one of the risks in the position it is in now, congested into production for the Prairie Provinces, I think is the crop risk. We are quite under the hazard of good crops or bad crops in these Prairie Provinces, and to my mind it is quite conceivable that the consumption of oil in these Prairie Provinces may fluctuate, as much as 25% owing to crop conditions. We know it was a 6,000,000 barrel year in 1938. What is it going to be in 1939 and the years following that? And in that connection, Mr. Chairman, I would like to call attention to the Exhibit that was handed in this morning showing the growth of the fixed charge for amortization. That is Exhibit "111".

Q Exhibit "111"?

Q THE CHAIRMAN: That is for the year 1939?

A Yes, sir.

Q Yes?

A Where on an annual basis the provision for the year 1938 is going to be....well, I will just have to add a few figures together here. On an annual basis for the year 1938 the provision for amortization for the complete year - we only have the nine months' figures in these statements - is going to be some one hundred and fifteen thousand dollars.

Q MR. NOLAN: What you have done, Mr. Taylor, you have taken your figure of $86,234.47 on statement 8 of Exhibit "100" and you have projected.....

A Oh, no.

Q Haven't you taken for the purposes of making that computation .....

A I have taken that plus that.

Q The $72,000.00 and the $13,000.00. Yes. All right.

A The figures I have taken are taken from that statement. Beginning with the first figure, which is $72,429.52, and added to it the second amount below there, that is three month's amortization being one-third of the above amount, $24,143.18, Then we take into the utilities section $13,804.95, and $4,601.65, which adds up to about $115,000.00. That will be the amortization for the complete year of 1938, whereas for the complete year of 1939, that is, taking cognizance of the budgets, we have $167,070.39, an increase of approximately $52,000.00. I think that is a feature that should be taken consideration of in connection with any calculation looking to the future, that there is going to be this increase in 1939 over 1938, a known increase, which is going to be that fixed amount additional for 1939, plus amortization on any capital expenditures which take place from year to year following that.

Q MR. COMMISSIONER LIPSETT: Would not that, Mr. Taylor, that $260.000.00, if it is spent, would not that be spent with the object of getting increased revenue?

A I do not think the company has any option as to whether they spend it or not, that $260,000.00. They have to service the field and take pipes wherever they are required. I believe that is one of the measures of service which they have to give and I think that is something that should be kept in mind in this whole picture. That the reinvestment

of this capital is not done at the option of the pipeline department but it is done to service the field, as I see it.

Q You mean - we will probably hear all about that and, perhaps, we should not ask you, but we have not heard anything about it until now - is your idea that there is some compulsion on them to spend this money on extra lines, whether there is a profit to be made out of them or not?

A I believe they are bound to keep their shipping order. As I see it, they have to go out to a new well, whether it is one mile away or five miles away, and they have to be ready when the oil comes.

Q You mean by Government regulation or simply to keep a competitor out?

A Well, to service the field properly. That is the way I would look at it.

Q If it was profitable I suppose you would have in mind the Home-Millarville well, or some well like that?

A Any well wherever it may come in, sir. You have to get out there with your line.

Q Is that something that is imposed on them or is that something they do quickly in order to prevent anybody else from getting a start?

A It would take anybody a long time to get in the position of competing with them. But in the meantime I do not know what you are going to do with the flush production of that well. I do not know all these technicalities, but just looking at it from a layman's point of view.

Q MR. NOLAN: Is that all you want to say about that phase of hazard?

A There is another phase....

Q THE CHAIRMAN: I do not understand on that point. I quite understand about the capital expenditures

going out to a new well. What portion of this is just maintenance?

A There is no maintenance whatever in this capital.

Q None whatever included in this?

A No.

Q Mr. Coultis has to recondition some parts of your line, is that capital?

A No, sir, that is all charged against operation.

Q All against operation?

A Yes.

Q So that the only capital expense that you have in mind in the discussion in hand relates to new lines, new gathering lines?

A Yes, and the possibility of new trunk lines.

Q The possibility of new trunk lines. Well, is that right?

A It depends on the production that is brought through. My recollection is that the present trunk line may be good up to say 10,00C,000 barrels. The expectation of having to build a trunk line should be out of the picture for a while provided that this production does not go over - or the number of barrels we seek to bring through the pipeline does not exceed say 10,000,000 barrels, if that is the figure.

Q So that your maintenance and reconditioning may be paid out of operating costs?

A That is right.

Q And since you do not anticipate a trunk line, another one, you are really down to new gathering lines, aren't you?

A I think you are down to the necessity of renewing a considerable portion of your equipment, that has gone through wear and tear.

Q Have you any basis for saying that, because that is not the

picture I get from Mr. Coultis, if I understand him aright.

A Except there is some of that equipment.....

Q Yes, or Mr. Hill.

A Some of that equipment may have been there - I do not know just what the position is in that - but if you take the life of the field at say thirty years, one could hardly expect that equipment that went in there in 1925 would last physically up to the end of your thirty year period. I should think there would be occasion for considerable renewal of matters like pumps......

Q We are led to believe that has been done and excellently done.

Q MR. NOLAN: What you are saying, Mr. Taylor, is there is additional expenditure in connection with gathering lines and pumping stations?

A No, I am thinking of this as a picture back to 1925. I do not suppose there is any of the equipment that was originally there in 1925 now there. I do not know as to that, I have not made any study of it. But I know in the ordinary course of any other industry that there is the necessity of renewing items of equipment from time to time. I think that that would be a feature that will be a more potent one the longer the life one takes of the field. There will be some element of wearing out of equipment outside of the pipeline. I believe the pipeline carries very little physical depreciation.

Q All right. Now, are there any more hazards you want to discuss?

A I would like to indicate or relate these hazards which I have enumerated to the hazards of an ordinary industrial hazard. I have had occasion in the past ten years to make,

in the ordinary course of my professional duties, to make calculations of the value of shares in more or less private companies, companies for which there was no market quotations. The estate would come to us and ask us to make an estimation of the valuation of these shares. And these three concerns were fairly representative industrial concerns. One was a sole leather business. One was an old established stationery business. Another was a furniture business. Each one of these companies had a good back history of earnings, and a reasonable expectation of their continuance. Well managed businesses. In each case I made that calculation on the basis of 10% return and in this case we were measuring the capital by income rather than income by capital. So the way we make these calculations is to take the average earnings over some reasonable period, five or six years, and arrive at the annual net earnings and in this case assign a value of $100.00 for each $10.00 of earnings, putting them on what we would say a 10% basis. I think Dr. Boatright in his evidence mentioned 10% as a reasonable return of an industrial - I think he said an industrial institution. And I should take into consideration the special hazards connected with this business when I say from a consideration of these hazards that we know in any ordinary industrial business, the risk is twice as great and the return should be 20%.

Q Now, that brings us to the last point that you are going to give me, the calculation of the Toronto pipeline?

A Oh, yes. Considering there is nothing to compare this particular operation of ours with......

Q THE CHAIRMAN: What does that bring you to per barrel, the 20%, did you figure it out?

A I did not figure it out. As a matter of fact, I want to make this clear, Mr. Chairman, I have made no calculations as to the rate, or return on investment, but that I would be very glad to do. These statements I put in this morning on the 5, 10, and 15 years' basis, they stopped just short of that point of calculating what the price should be on the basis of any rate of return. But that is a thing that can be very easily calculated and if you would like me to do so I shall be very glad. What rate shall I take, sir?

Q THE CHAIRMAN: You have just said you should have 20% return?

A Shall I carry it to that rate, sir?

Q Yes. You are the one who is making the present submission.

A All right, I will be very glad to do that.

Q We are not asking you to give judgment or a recommendation. We are asking for your submission as to what it should be.

A I can work it out at different rates.

Q You have gone so far and you might as well go the rest of the way.

MR. FRAWLEY: He seemed shy stopping just there.

MR. NOLAN: You stopped at 10% and we thought that was modest too. However, we will work it out, sir, and make it so comprehensive as it will be of use to the Commission.

THE CHAIRMAN: All right.

A Now, as I said, there is no parallel operation with which this pipeline can be compared, and I wrote to the New York office of my firm, after I went back from the Christmas recess, and they in turn wrote to our Washington office and got the returns of the Interstate Commerce Commission

for the years back to 1934. And I looked through these returns and without any other consideration, endeavoured to choose two lines reporting to the InterState Commerce Commission which seemed comparable to our Royalite line, as to mileage and the barrels transported. These two lines are the Toronto Pipeline Company and the International Pipeline Company, which I find Mr. Hill dealt with in his report in a more or less cursory way. These statements have been prepared to show the comparisons for the years 1934, 1935, 1936, and 1937, and in the case of the Royalite the nine months ending September 30th, 1938, with the results of the Toronto Pipeline Company and with the results of the International Pipeline Company.

Q THE CHAIRMAN: Of course, the two criticisms you have in mind of the conclusions which Mr. Hill has drawn, is that these lines were in the main at least carrying their own oil - that is their own oil or that of their parent companies, and secondly, the rates fixed were fixed by themselves and had not been subject to regulation of any kind?

A Yes.

Q Nor had the rates so fixed come under review. Under these circumstances, do you consider them of value as a guide?

A I think there is one feature that is brought out in these comparisons and that is that these companies were apparently not called on to, what we call, plough back their earnings into capital. Their capital ran along fairly steady and they apparently got their rate of return without being under the necessity if reinvesting it.

Q THE CHAIRMAN: No one apparently ever suggested that they should, it was never in dispute was it?

[illegible]

J. [illegible]

[illegible] looked through [illegible]

[illegible], endeavoured

to arouse two lines according to the [illegible] Commission which seemed [illegible] royalties [illegible] on the mileage and the barrels [illegible]. These two lines are the Toronto Pipeline Company and the International Pipeline [illegible], which I find [illegible] dealt with in the report in a more or less cursory way. These statements have been prepared to cover the [illegible] for the years 1932, 1934, 1936, and 1937, and in the case of the [illegible] the nine months ending September 30th, 1938, with [illegible] of the Toronto Pipeline Company and also [illegible] accounts of the International Pipeline Company.

[illegible]

we have [illegible] the [illegible] which [illegible]

[illegible]

carrying their [illegible]

of their present [illegible]

[illegible] by the [illegible]

[illegible]

A Between......

Q Between these two companies, I may have the wrong impression about this, but I thought the evidence brought this out, that those rates are recorded?

A Yes.

Q As the rate fixed by the Company itself, it has not been contested by anyone else?

A No.

Q And in respect of which there has been no ruling?

A No.

Q Now what they did with profits, or did not, is quite their own volition under those circumstances.

MR. FRAWLEY: Added to the fact that the rate charged was merely a domestic arrangement between the parent company and its subsidiaries.

WITNESS: I heard that situation brought out in evidence through Mr. Hill, and that is the first time I knew that there was any such relationship.

Q In those circumstances it would not be much help to us.

A That is so. The only, I would say the only reason I took them was that they seemed somewhat of a parallel to mileage and barrels transported.

THE CHAIRMAN: Well we might consider them further in the morning.

(The Hearing was here adjourned to be resumed at 10.30 A.M., January 25th, 1939).

....

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J. J. FRAWLEY

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The Province of Alberta

IN THE MATTER OF THE PUBLIC INQUIRIES ACT

—and—

IN THE MATTER OF a Commission, dated the 12th day of October, A.D. 1938, to inquire into matters connected with Petroleum and Petroleum Products

Commissioners:

The Honourable MR. JUSTICE McGILLIVRAY
(*Chairman*)

—and—

L. R. LIPSETT, ESQ.

Session:

CALGARY, Alberta JANUARY 25th, 1939

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I N D E X

Page.

VOLUME 22 - January 25th, 1939.

WITNESSES:

E X H I B I T S

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....

[illegible]

JAMES WATT TAYLOR, having been recalled examined by Mr. Nolan said:

Q Mr. Taylor, since the adjournment yesterday you have directed your attention to a calculation to show what has been invested annually in the pipeline department from the profits of that department?

A Yes.

Q And have you prepared a statement?

A Yes.

Q Perhaps you will submit that now?

A The description of this statement is "Royalite Oil Company, Limited, Cash Investment in Pipeline Department, Direct Assets, showing Proportion Invested Annually from Profits".

Q And that would be Exhibit "114", if you please Mr. Chairman.

THE CHAIRMAN: Yes.

(STATEMENT PRODUCED BY WITNESS HERE MARKED EXHIBIT "114").

Q Now take the Statement, Exhibit "114", will you be good enough to explain how that is set up?

THE CHAIRMAN: I think we start off with different figures.

MR. NOLAN: Your Lordship is thinking of that, 160,000 figure, which has been mentioned.

MR. FRAWLEY: Exhibit "109".

MR. NOLAN: Exhibit "109".

Q MR. NOLAN: The Chairman, Mr. Taylor, has drawn your attention to that total which is shown on Exhibit "109" for the year 1925 of $160,389.77?

A That includes the proportion, this deals only with the direct pipeline assets. The utility assets come into the pipeline calculations in percentages, different percentages each year.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

and we have dealt here only with the direct assets.

Now as to the basis of the net profits included in this statement for the period from January 1, 1931 until September 30th, 1938, these figures are taken from the "C" Exhibit in Exhibit---

Q The C statement in Exhibit "100"?

A The C statement in Exhibit "100".

Q Yes.

A In regard to the years from 1930 to 1925 inclusive, the figures have been prepared by the company, using the same basis as the basis applied in the statements attached to Exhibit "100". In applying overhead we have on the books, on the books there are the direct, there are earnings, the transportation earnings separately and the direct expenses of the pipeline department all through those years, is kept separately in the books. There is no question about them, they have been so segregated as was the case in the period following.

Q No difficulty can arise there?

A No, no difficulty can arise, so to get the overhead percentage to add to those direct expenses, we take the relationship of the overhead expenses in the years 1931 to 1936 and calculate them as a percentage addition to the direct in those five years and use that same percentage in adding to the direct expenses for the five years 1925 to 1930.

Q Let me see if I understand that, in order to ascertain the distribution of the indirect expenses for the years prior to 1931, you take the relation which exists between, the average I take it?

A The average.

Q Of the year 1931?

A Yes.

Q That the indirect bear to the direct?
A As shown on our C Statement.
Q As shown on the C Statement in Exhibit "100"?
A Yes.
Q And you applied that percentage to these earlier years?
A That is right.
Q That is what one might call a rough and ready way of doing it?
A It is rather a rough and ready way of doing it. It might have been a fluctuating feature year by year.
Q THE CHAIRMAN: But you would expect it to be approximately accurate?
A I think in taking the average over a number of years, I think you would arrive at an approximately correct answer.
Q MR. NOLAN: And it is clear to the Commission how that is being done?
THE CHAIRMAN: Yes.
Q MR. NOLAN: Now having used that method, Mr. Taylor, what is the result obtained?
A The aggregate result.
Q I beg your pardon?
A The aggregate result.
Q No.
A Shall I go over the statement from the beginning?
Q If you like.
A I would like to do that.
Q And I would like you to do it.
A The first figure $150,369.84 is the original investment made in 1925.
Q THE CHAIRMAN: Before you go to that, may I interrupt, the heading is "Cash Investment in Pipeline Department Direct Assets showing Proportion Invested Annually from Profits"?

A Yes.

Q Just what do you mean by "Direct Assets" and what would be "Indirect Assets"?

A The indirect assets would be the proportion of the utility assets which, as I mentioned, is a varying factor from year to year. The method in which they have been dealt with in our statement is to add our overhead percentage, to take our overhead percentage of the total, supposing the overhead percentage is 12, you take 12% of the total direct assets and consider those as being, you might say, held for account of pipeline department.

THE CHAIRMAN: Yes.

Q MR. NOLAN: But you are not dealing---

A Those are not dealt with here in any way at all but when we come to consider the question of amortization, perhaps I should deal with it now, that would be the better way, I would call your attention, sir, to this little slip attached to that, which shows just what the position is in connection with the indirect assets. Now the accounts, the accounts include provision for amortization of the indirect assets and the total included in that record is $75,000 over all this period and in view of the impossibility of making a calculation as to how much of that went into these indirect assets, the assumption has been made that all of the amortization was spent by the company generally in adding to those utilities, in indirect assets.

Q THE CHAIRMAN: By the company generally?

A Yes. You see those assets are not owned by the pipeline company, by the pipeline department.

Q MAJOR LIPSETT: Is that second page, is there a slip there, you mean the 1st of January 1936 or the 1st of January 1926

on page two?

A Is that in the heading?

Q Yes, it says a statement showing the amount.

A That should be 1926, I am sorry. Well that is the manner in which the indirect assets have been dealt with in this statement. It has been assumed that all the amortization which was provided and which is provided in these statements has been spent. Now shall we follow the statement through. The first item you see is in 1925, $152,369.84 was invested by the company in the pipeline department.

Q MR. NOLAN: And you call that the cash invested?

A That is the cash invested in indirect assets of the pipeline department, found by the company.

Q Then what is the balance available?

A The balance vailable is that same amount, 1926, we bring that balance available forward at $152,369.84. We add to it the loss--

Q It says "add profit"?

A Well it is difficult to deal with these red figures. As a matter of fact it is an addition. We invested $152,000 in cash and then we lost $6,712.84 and we consider that an addition to the investment.

Q Yes.

A And in that year we have a provision for amortization of $7,518.38.

Q MAJOR LIPSETT: Now in dealing with that figure, Mr. Taylor, I take it from the heading that that is not the figure which actually appears in the books, that is a figure which you have made up on the basis of 1946?

A On the basis of 1946, yes.

Q But cannot we have the actual figure on the books?

Q MR. NOLAN: Well I understood yesterday that we were to be permitted to use our own basis in arriving at the answer for those early years.

MAJOR LIPSETT: Whether or not they were different from the figures in the books.

Q MR. NOLAN: Well then what do you do, you add the provision for amortization of direct assets and you get a figure of?

A We get a figure of $151,564.30.

Q And that represents what?

A That represents the investment by the company at that time out of its own funds.

Q Yes?

A Then there is invested in that year, 1926, in fixed assets, $10,769.52.

Q That is new money?

A New money.

Q Which went in?

A Which is added to the $151,000 and it brings it to an amount of $162,333.82, which represents the new money found by the company up to that date.

Q THE CHAIRMAN: How do you get the figure $151,564.30, what is subtracted, you start off with $152,369.84?

A Yes, and we add to that $6,712,84, which is the loss for the year.

Q MR. NOLAN: You add the loss?

A Yes.

Q And you subtract?

A And you subtract the amortization, $7,518.38, that gives us our figure of $151,564.30.

THE CHAIRMAN: I suppose it is quite proper but I

have difficulty in appreciating how you get more money by adding a loss.

Q MR. NOLAN: Yes, why in the first place do you add the loss?

A Well the loss would represent, you might say capital loss by the company.

Q Well is it proper to add a loss?

A I think it is, sir, because in the following year we take in the profits in the same way.

Q I suppose that is right?

THE CHAIRMAN: I suppose so.

Q MR. NOLAN: Then you add the loss.

A Yes.

Q Then you deduct the amortization?

A The amortization of $7,518.38, gives us the cash available, what it is called, that is the money found by the company at that point, of $151,564.30.

Q And then new money is brought in and invested in fixed assets of $10,769.52, which brings the balance invested at that date by the company out of its own funds of $162,333.82?

A Yes, now that is the manner in which this statement has been built up and perhaps I need not go over every year.

Q Just do another year for me, will you, Mr. Taylor, please, $162,333.82, then we carry that figure---

A We carry that forward to 1936.

Q And then what happened in that year?

A We lost $12,099.18.

Q All right, and the amortization?

A The amortization was $8,741.11. The cash investment by the company out of its own funds at that point was $165,691.89.

Q Yes.

A Spent $37,442.50. Therefore at the end of 1927 the Royalite Oil Company had of its own money in the pipeline department $203,184.39.

Q And then we take that into the year---

A We take that into the following year and go through the same process.

Q Was there a loss or profit the next year?

A That is the year---

Q 1928.

A There was a loss of $14,754.54.

Q Yes.

A Provision for amortization to direct assets by December 31st, 1946, $12,417.36.

Q Well when did this company get back out of profit for the first time what it had put in in money, into this business?

A In 1932, sir.

Q In 1932?

A Yes.

Q Now just to point that out---

Q THE CHAIRMAN: 1931 or 1932, Mr. Taylor?

A In 1932, sir.

Q MR. NOLAN: Let us begin that year, you had $104,873.10 as the balance?

A At that point the company had invested of its own money $104,873.10. Now we commence 1932 with that balance of $104,873.10, we add the profit for the year 1932, $57,627.03, add the amortization $30,572.19, and we get to the point that, at that point the company had found an amount of $16,673.88, that is the amount which the company had invested.

Q Yes.

A Now through the retirals, the company's assets were reduced

by $68,260.86, that is no new money was invested, and this 68 thousand came out, so that we have the difference between the $68,260.86 and the $16,673.88, namely, $51,586.98, which represents the amount by which the profits earned plus the amortization, the net profits earned plus the amortization exceeded the investment back into company assets.

Q THE CHAIRMAN: By.

A By $51,586.98, that would be at the end of 1932, sir.

Q MAJOR LIPSETT: Does that mean, Mr. Taylor, that at that date they had got all their money back, plus 51 thousand dollars?

A All the money which was put back into the company's assets plus 51 thousand dollars.

Q MR. NOLAN: All that had heretofore been put in?

A Yes.

Q THE CHAIRMAN: That is on the basis of amortization in 1946?

A Yes.

Q MAJOR LIPSETT: And that included the heavy capital outlay in 1929?

A Yes. I would like to bring up point which, I should have followed it up, when you were questioning me as to the propriety of taking this, bringing back this 6-inch loop. Now I think the situation is taken care of in that; that the capital invested is taken care of in the figure in 1929 set there, it is given credit for and included in that figure.

Q THE CHAIRMAN: What is that now, you say it is taken care of, what do you mean?

A It is given due weight in that, in the year 1929, there is included in the figures shown there---

Q What figures?

A The figure of $302,628.20, there is included the cost of the 6-inch loop which was brought into the capital account in that year, so that it is included as an investment which we made out of our, which we made in that year and so causes, gets its weight as a new investment, gets some weight as a new investment.

(Go to number 2826)

A [illegible] included [illegible]

[illegible] the entire [illegible]

[illegible]

Q MR. COMMISSIONER LIPSETT: I am just trying to get it quite clear in my own mind. Does that mean that taking care of that mistaken investment, or the investment that had to be changed, that is still taken care of and they still have $51,000.00, back over and above all their capital, in 1932?

A That is the situation.

Q And everything taken care of up to that time?

A Yes.

Q Plus $51,000.00?

A Yes. That is through amortization and net profit.

Q THE CHAIRMAN: And amortizing on your basis as of December 31st, 1946?

A As I stated. I want to make that quite clear.

Q MR. COMMISSIONER LIPSETT: In that particular period, Mr. Taylor, I suppose if the depreciation was taken at 10% your profit figure would be correspondingly less in that period, would it not?

A Oh yes. I have not worked out the figure, but offhand I would say that the average would be less than 10%. About 5% if it is spread over till 1946.

Q Yes?

A I can make that calculation, to show just how it sits in the average way. I feel quite satisfied it would be less than 10%.

Q The effect of that would be that on the 10% basis your profits would be less in the earlier years, and greater in the later years?

A Yes, that is how it would work out, because your amortization will grow year by year.

Q MR. NOLAN: Does it matter what basis

of amortization is used, yours or the Company's, for the purposes of this statement? It is added back in, is it not?

A Yes, it is added back in. So that I take it that whatever amortization you set up you add it back in in any case, when you are considering the cash situation. That is to say that in this figure, if we take the figure of 1929 of $159,602.53, and the amortization amount of $23,780.06 for the purposes of this cash investment statement is added back.

Q It matters not then what basis of amortization is used?

A That is correct. The amount is added back in any case.

Q MR. COMMISSIONER LIPSETT: But on a 10% basis a lot more of the assets would be amortized today than on this 1946 basis would there not?

A Well I would not wish to say that offhand, because there is an average situation working in here which changed from year to year. I would not want to say offhand how it compares with the 10% basis for instance.

Q MR. NOLAN: Am I not right in saying it makes no difference what basis of amortization you use, you add it back in this cash position?

A Yes, for the purposes of this statement.

Q Only?

A For the purposes of this statement only. Which takes the figure which is the net profit, in which there is a certain amount deducted for amortization. You add back that amount. You take that same amount and add it back so that whether you have a 10% or a 5% it does not matter for the purposes of this statement.

Q Because this is a cash statement?

A Because this is a cash statement.

Q And we were asked to paint a picture of the cash position?

A That is right.

Q And that is what this does?

A That is correct.

Q Now this money shown on the right hand column as being the balance available, is cash we had in the business, that we put in from time to time?

A Well the red figures represent cash put in the business, that is the balance at the end of each year which the Company had supplied from its own funds and put in the business up to the point where we see the red figure of $104,873.10, which is at the end of 1931. Then from that point onward, the black figures represent the cash money that the Company had recovered from its profit, after meeting all its expenditures on capital assets. On direct capital assets.

Q I see. We made large profits in 1929 of $159,000.00 and $211,000.00 in 1930. What did we do with that money?

A That money was invested in capital assets in 1929 to the amount of $302,628.20.

Q We put it back in the business?

A We put it back in the business.

Q What else can you do with profits besides put them back in the business?

A You can distribute them in dividends if you had them available in cash.

Q But this money was put back in the business?

A This money was put back in the business.

Q MR. FRAWLEY: And you did not have any dividends?

Q MR. NOLAN: Then would you mind just directing your attention to the totals under these columns and not go through the statement in any more detail, if you will please.

MR. COMMISSIONER LIPSETT: Perhaps Mr. Nolan, you would consider 1937 and 1938 when the next large capital outlays were incurred.

Q MR. NOLAN: Take the year 1937?

A Yes sir.

Q And 1938?

A 1937, the amount which had been recovered out of these profits after meeting all capital expenditures was \$507,270.28. The profit for the year 1937 was \$296,153.77. The amortization which had been deducted from these profits and is now added back \$53,360.88. So that the Company had available in cash out of profits, after meeting the capital ploughed back of \$856,784.93, and had expended in addition the direct capital assets \$411,763.40, leaving a balance of \$445,021.53. Now the relationship within that year is the profit was \$296,153.77 and we added back the amortization provision of \$53,360.88, giving a total of \$349,514.65, which compares with the amount of \$411,763.40 which was put back into Fixed Assets. Then carrying our balance of \$445,021.53 to 1938, we add the profits \$368,698.33, provision for amortization of direct assets by December 31st, 1946, \$72,429.52, and carrying on this little - you may call current account of the cash - we get a figure of \$886,149.38. There was spend in additions

to direct capital assets $475,660.30, leaving a balance of $410,498.08. I should like to relate the situation for the nine months ending 30th September, 1938, as to profit against capital additions in the same way I did in 1937. We take the net profit as shown of $368,698.33, to which we add $74,429.52, being the amortization provided in these nine months, giving a total of $441,127.85, which compared with the amount of $475,660.30 invested back into Fixed Assets.

Q MR. NOLAN: You have a reconciliation statement at the foot, Mr. Taylor?

A Yes sir.

Q What does that mean?

Q MR. COMMISSIONER LIPSETT: Just before you pass from that. That figure, Mr.Taylor, beginning at 1937?

A Yes.

Q That figure of $507,270.00?

A Yes sir.

Q Does that represent the balance that the Company had over and above all the capital they had put in?

A Yes sir, that is right.

Q And everything paid for up to that time?

A Yes. They had recovered out of their profit all the investment made in capital assets and had this balance over.

Q Yes, and everything paid for including the new pipe line?

A Yes sir.

Q That was put in in 1929?

A Yes sir.

Q Now at the end of that year 1937, they had put in the first part of this new pipe line apparently. They had

spent $411,000.00 on that?

A That would be largely that new 6 inch line.

Q And they had reduced their current balance then to $445,021.00?

A Yes sir that is right.

Q So their actual cash position was $60,000.00 worse?

A Yes.

Q And they had $411,000.00 more property?

A Yes, more property.

Q And at this period in September 1938 their cash balance is $410,489.00?

A Yes sir. It is reduced $35,000.00 from 1937.

Q Yes?

A Which means that they put $35,000.00 more back into the fixed assets than they got out of their profits

Q And after doing all of this capital outlay in 1937 and 1938, your cash position is the difference between $507,270.00 and $410,489.00?

A I did not quite catch those figures. Will you repeat those?

Q From the beginning of 1937?

A Yes.

Q To the end of September 1938?

A Yes sir.

Q When this $800,000.00 or $900,000.00 was expended?

A Yes.

Q Their cash position is reduced from $507,270.00 to $410,489.00.

A That is right sir. It is reduced roughly about $96,000.00.

Q And after fully paying for all this capital outlay on these new lines?

A After paying for the two figures you see there, $411,763.40

and $475,660.30. That is correct.

Q MR. NOLAN: That is taking all our cash profits and all our reserves for amortization?

A Yes sir.

Q THE CHAIRMAN: And that is granting you no interest on your investment over these years?

A No interest on the investment. No outgoings by way of dividends from 1925 to 1938.

Q MR. COMMISSIONER LIPSETT: Except insofar as that is represented by this sum of $410,000.00 that they still had over and above the property?

A That is the only amount that would be available to pay interest or dividends.

Q MR. NOLAN: And that is for the period of 13 years?

A Yes, 1925 to 1938.

Q THE CHAIRMAN: As I understand the position, to put it in a simple fashion for one who must be simple in these matters, you start off with $152,369.84 invested by the Company in 1925. You end up in September 1938 with $1,465,150.56 worth of capital assets?

A That is right.

Q And $410,489.08 in the bank?

A That is right, Sir.

Q MR. NOLAN: Should that capital asset figure not have a deduction made upon it of the reserve for amortization of $386,626.00?

THE CHAIRMAN: Should it be added or taken off?

Q MR. NOLAN: Would you not take it off in this instance? You have there under capital assets

$1,465,150.56 worth?

A Yes.

Q Of capital assets?

A Yes.

Q Is that right?

A No, that is not right.

Q What is wrong about it?

A That was the cash we put in, but that cash has depreciated by the amount of amortization. We do not have that much value now.

Q I think that is clear.

Q That is the amount of money put in?

A That is new money.

Q $1,465,150.56 and there should be deducted from that?

A Deducted from that.

Q The amount of amortization in the amount of $386,626.00?

A Yes sir.

Q Why do we deduct that?

A That represents the reduction in value of the assets through its use over these years.

Q THE CHAIRMAN: You have taken out, haven't you, I suppose that is quite right, but so I may understand it, when you amortize you should get that money back, and replace the asset and leave the position the same. If I may make it simple to you, Mr. Nolan, that you might examine it further, by presenting my difficulty to you. $100.00 was invested in an asset. You take out 10% per year for what I have thought of as depreciation in times past. Theoretically I thought at any rate, that $10.00 went into the bank, and at the end of 10 years your asset would be theoretically gone but you would have your $100.00 in the bank. So that they would balance each

other. That is perhaps quite wrong.

MR. NOLAN: In this statement haven't we added the amortization reserves?

A Yes sir. We have considered the amortisation reserve as if it were cash we were getting back.

Q You add it on in this statement?

A Yes sir, it is added on in that statement, and it is considered cash coming back to them.....

Q THE CHAIRMAN: Didn't you tell me in the very first column that was carried right through that you added as profit, although it was a loss, your second column, and you deducted the third one?

A No sir. We added the third one.

Q MR. NOLAN: Is it because of the difference in the colour of these figures as to what you do?

A Yes sir, it is. It is the colour of the figures that is the governing factor there.

Q So you did give that explanation when you started with that first line?

A Yes.

Q If you were dealing with the last line you would not do it that way?

A No sir. It is added back in the last line.

Q So is it proper to take from the $1,465,150.00, to take the amount of the amortization reserve?

A Yes sir.

Q Well now, the reconciliation statement. Would you explain that?

A The reconciliation statement takes in total, the figures from the detailed position year by year, and the profits

from 1925 to 1930 as estimated by the Company were $337,914.93. The profits from 1931 to September 30th, 1938, as per Exhibit "B" attached to Exhibit "100", $1,151,098.71, giving a total of $1,489,013.64. Then we add back the amortization.

MR. NOLAN: Why do we add?

A Because it is black, I suppose.

Q This may be simple to you but it is not to me.

A We add it back, sir, because we got that. We consider we got that out in cash $386,626.00 and that gives us $1,875,639.64.

Q THE CHAIRMAN: Just pause there long enough to tell me what does that represent, that $1,875,639.64?

A That represents the cash which came out of the earnings from the period from 1925 to September 30th, 1938.

Q MR. NOLAN: Yes, and which.....

A Of which we spent in capital assets $1,465,150.56, leaving net cash at September 30th, 1938, assuming no dividends were paid, and ignoring interest, of $410,489.08, which agrees with our balance at the close of the period in what I call the little current account up above.

Q THE CHAIRMAN: So that to put it another way again in simple fashion, between the period 1925 and 1938, you are ahead either in cash or in capital assets on hand to the extent of $1,875,639.64?

A That is right, that is correct.

Q On an original investment of $152,369.84? I suppose that is perhaps not right to put it that way.

MR. NOLAN: No, because we put money in for the first six years of this pipe line's life?

A Oh yes.

Q What the Chairman is directing your attention to is this, did the figure of $152,000.00 like a snowball, become a figure of $1,875,000.00? Was that the original investment, $152,000.00?

A Yes sir, it was the original investment.

Q For that year?

A For that year.

Q But there were other years immediately following in which money was put in?

A Oh yes.

Q All these black figures in the second last column beginning with $152,369.84, plus $10,769.00 and $37,442.00 and so on?

A Yes sir, all the figures starting with the $152,000.00 and following up year by year, all that was new money put in until you come to the point where the change takes place, and we have $51,586.98.

Q MR. COMMISSIONER LIPSETT: The other money having all been got back in the meantime?

A That is right.

Q MR. NOLAN: The other money having been got back in what meantime, having been got back in 1932?

A Yes, in 1932. Yes. There was an investment by the Company in addition to the $152,000.00, there was an investment for some 6 or 7 years.

Q Which we did not get back?

A In those years. Which we did not get back in those years.

Q But you did get it back, Mr. Taylor, as I understand by 1932?

[illegible]

A That is right, yes sir; by 1932. There was a period of 7 years when there was new money going into the pipe line.

THE CHAIRMAN: Now what is that?

MR. NOLAN: The witness was explaining that there was an investment in the early years, at least for the first 6 years, which was not available because the profits were not there to enable them to make that investment?

A That is correct.

Q But by the year 1932 the position was that all that had been put into the business had been returned from the profits made?

A That is correct, sir.

Q And that was what Mr. Commissioner Lipsett has been interested in.

Q THE CHAIRMAN: Do I understand you, Mr. Nolan - I do not know whether I understand - but do you mind telling me what are we to conclude when we see the red figures? There are times when you subtract the figures because they are red, and you add them because they are black. I would just like to be clear on this if I can be?

A I do not think Mr. Nolan can explain that to you, Sir.

Q Well will you?

A I will try to.

WITNESS: I think the interesting red figures are in the column "Deduct Cash Invested in Direct Assets".

Q THE CHAIRMAN: Yes?

A Now, we have black figures all the way down the line, and then there came a year when we took out of our fixed assets more than we put back; in other words, we dismantled or took up pipelines or did something like that and we had a figure of credit to our capital assets instead of a charge, take that figure of $35,395.90?

Q Yes?

A Our expenditures in that year might have been $30,000.00 and our recovery $65,000.00. Then we have more recoveries than we have new cash and we get this credit so that, now if you look at the red figures just immediately in front of the $35,000.00, the $140,271.00.

Q Yes?

A Which is a red figure.

Q Yes?

A Which was cash invested by the company at that point, new money at that point, of $140,271.00, so we get $35,397.90 back through recovery of fixed assets, and we get a figure of $104,873.10, which represents the money which had to be found by the company up to that time. Now, you might have an entirely different situation with other red figures, as a rule, as a general rule a red figure means a deduction, but you cannot follow that absolutely because you have occasions when the red figures represent an addition. When you get two red figures together, but not always.

Q The expression "in the red" does not always stand?

A No, not always.

Q MR. NOLAN: Now, wait a moment, we were "in the red" in the sense that we had put into this business $104,873.00 more dollars than we took out of it in the year 1931?

A At the end of.....

Q 1931?

A 1931, that is correct.

Q Now, I mean, to use that colloquial expression which has been suggested to you by the Chairman, we were "in the red" to that extent?

A In the red in the investment of cash.

Q We put in more cash than we took out by that amount of money, namely, $104,000.00?

A Up to that point.

Q THE CHAIRMAN: After allowing, of course, for the excess of profits over losses in that same period?

MR. NOLAN: Yes.

THE CHAIRMAN: I mean, it may make no difference, Mr. Nolan, on some theories, but you did not take that all out of your pocket, I take it?

MR. NOLAN: No, no.

THE CHAIRMAN: If I understand the witness aright.

MR. NOLAN: That is right. We used what we had, my lord, I wonder if I could put that, we took what money there was available and we put it all back in again.

WITNESS: The money available from profits?

MR. NOLAN: Yes.

A Yes.

Q And put it all back in again?

A Yes.

Q But it was not enough by $104,000.00 at the end of 1931?

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A That is the situation, exactly.

THE CHAIRMAN: That is right.

Q MAJOR LIPSETT: And is that not subject to this qualification, Mr. Nolan, or Mr. Taylor, you had originally put in $152,000.00?

A That is correct.

Q At the end of 1931 you had only left in, $104,000.00?

A Yes, that is the figure, that is the cash investment by the company at that point.

Q You had taken out, between 1925 and the end of 1931, you had taken out $48,000.00 of the original $150,000.00 you had put in?

THE CHAIRMAN: And acquired.....

WITNESS: Yes.

Q MAJOR LIPSETT: You got $48,000.00 of your original money back?

A That is correct, sir.

Q And reduced the original investment to $104,000.00?

A That is correct, sir.

Q And you had done that at a time when you had made this capital investment of 1929, 1928 and 1929, of over $400,000.00?

A That is correct, sir.

Q MR. NOLAN: And that is without, we put in our profits and the whole of our reserves for amortization, Mr. Taylor?

A I beg your pardon?

Q You had put in your profits and have also put in the whole of your reserves for amortization?

A That is correct.

Q What does that mean?

A That is really adjusting your profits to a cash basis by adding back the amortization which is not a cash outgoing, merely a bookkeeping provision.

Q Yes?

Q MAJOR LIPSETT: And you had acquired assets, according to this cash investment in direct assets, you had acquired in the meantime capital assets of over $600,000.00?

Q MR. NOLAN: Capital assets of over $600,000.00?

A Yes, around $600,000.00, just looking roughly at the figure.

Q Which have depreciated, Mr. Taylor?

A Yes.

Q And in fact did depreciate?

A Yes, they must have depreciated.

Q And which depreciation just does not show on this statement?

A It does not show on this statement. This is a cash statement and a gross investment statement of the assets represented by this $1,465,000.00, are worth as much as the value as depreciated through wear and tear.

Q MAJOR LIPSETT: Now, Mr. Taylor, on that point, can you break up that $1,465,000.00 into cash and fixed assets or property?

A It is all fixed assets, sir, all fixed assets. The cash amount emerges as $410,489.08.

Q And that $1,465,150.00, you say, then requires to be depreciated?

A Yes, it is not worth that value to-day.

Q To-day?

A No.

Q Now, what I want to ask you, Mr. Taylor, is if you know, if those are the same assets which are in the valuation which Mr. Hill gave us?

A They will be, except for the 6-inch Loop, which has been taken back in these figures and the other items represented by the $56,000.00, which we discussed at the close of the session yesterday.

Q Mr. Hill, if I remember correctly, told us that on the reproduction basis those assets were worth $1,600,000.00 to-day, and if that is correct, there will be still a further depreciation on his value of this property, over and above what your figures show?

A That would be so, on the revaluation basis.

Q And your figure on his basis would have to be increased by $135,000.00?

A Yes, it is, based on his calculation of reproduction value.

Q THE CHAIRMAN: Without the 6-inch line?

A And without the 6-inch Loop, yes.

Q MAJOR LIPSETT: That is giving credit then to the 6-inch Loop because he is only valuing what is there to-day?

A Yes, that is correct, he would have the 6-inch Loop in, no, he would not have it in, I mean.

Q He would not have it in?

A He would not have it in, but we have it in.

Q You have it in?

A Yes, that is right.

Q MR. MCLEAN: Now, is there anything else, Mr. Commissioner, on this statement, Exhibit "114"?

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MAJOR LIPSETT: I am sorry to interrupt.

Q MR. NOLAN: Then, perhaps, we had better go on to the next point, if there are no more questions to raise, what do you want to deal with now, Mr. Taylor?

A I should like to deal with the statement which was put in yesterday, the statement of investment.

Q THE CHAIRMAN: Before Mr. Nolan proceeds, I am not sure about this second page of this Exhibit "114", Mr. Taylor, which we have been discussing, would you mind having that explained a little more for my benefit?

Q MR. NOLAN: Now, will you turn, please, to the second page, Mr. Taylor, of Exhibit "114", you mentioned it in passing, but would you mind explaining that again to the Commissioners, first of all it says "Provision for amortization" for the seven years and nine months ended September 30th, 1938, per Exhibit B, $59,399.38?

A This provision is on the indirect assets, that is the utility assets which are, which service the pipeline department in some degree.

Q THE CHAIRMAN: That is what I would like to get cleared up, if I can?

A Yes.

Q How are they treated, now, who owns them, the Royalite Oil Company owns them, of course?

A The Royalite Oil Company owns them.

Q When you deal with them for this pipeline division, for the purposes of the present Enquiry, do you treat them as though the Royalite Oil Company were renting them to the department or the department owns an interest in them, or what, if they own an interest in them in the sense in which we speak of interests, by the department, should it not be included in the capital assets here?

A The explanation of the manner in which the utilities are included in the capital investment in the statements in Exhibit "100".....

Q But I mean for the purposes of this front sheet?

A These utility assets are considered as being utility assets of the pipeline division, in a varying percentage each year. In the overhead percentage rate. Now, that is how both Mr. Morrison and myself in our statements have treated these utility assets. You cannot say to what degree they are used in the interests of the pipeline department.

Q No?

A But you make the best calculation you can and it is considered that the rate in which you distribute your indirect charges is the measure of the proportion of these uti ity assets which the pipeline uses.

Q Yes, but you immediately differ here, you have a page showing "Acquired Assets"?

A Yes.

MR. NOLAN: Now, there is a little note there, Mr. Chairman, I wonder if that note just under these columns of figures may not help us.

THE CHAIRMAN: "No allowance other than provision for amortization of indirect assets, has been made for cash investment in pipeline department proportion of additional indirect assets acquired during the above period."

Q MR. NOLAN: Now, the "indirect assets" is utility and service?

A Yes.

Q And the direct assets are these lines and pumping stations?

A Yes.

Q THE CHAIRMAN: Along the line of our questioning, Mr. Nolan, I do not know where it comes out, but we are told that certain assets have been acquired by the company, whatever they may be worth, and that it is in a certain cash position. Now, in addition to that, this department as such either had a proprietary interest in or the right of user, which is of value in money, surely, of real value in money, surely, to that department, if you think of it as a separate thing?

A Yes.

MR. NOLAN: Yes.

THE CHAIRMAN: Just as surely as this $410,000.00?

MR. NOLAN: Yes.

THE CHAIRMAN: It does not own that either, as a department, but we allocate to the department that sum for the purposes of our consideration; why not that interest which they have indirectly in the utility?

MR. NOLAN: In the physical thing represented by the Boiler Plant, for instance?

THE CHAIRMAN: Yes.

WITNESS: It is taken care of, I consider, in this way, my lord. The provisions for depreciation are shown on that statement, including the provisioms for depreciation on the proportion of those utility assets which we have considered as capital of the pipeline company year by yeqr.

Q MR. NOLAN: Yes.

A We add back that amortization, that is taken care of in these figures, and we assume that that was handed over to the Royalite Company and was invested, reinvested in the general 100% of the utility assets.

Q You are amortizing these indirect assets but you do not set them out to go into the column of total assets as I see it?

A Well that would be an impossible thing to do, sir.

Q MR. NOLAN: Why?

A Because the percentage that we use jumps around from year to year. It is the percentage of indirect costs that is used on all these statements, in setting up these utilities and then we amortize them on that same basis.

Q Yes, but what the Chairman says, in your capital assets you have nothing to show the physical value of the boiler plant?

A That is right in these figures.

Q Well why have we not?

THE CHAIRMAN: That is it, I would like to know.

MR. FRAWLEY: You can take the percentage in 1925.

THE CHAIRMAN: We have had no difficulty in more or less arbitrarily dealing with indirect profits.

MR. FRAWLEY: You have lots of percentages lying around, use them.

Q MR. NOLAN: Well Mr. Taylor, what about it?

A Well here is the situation which would emerge from there, my Lord, supposing your percentage that you take for capital purposes is 10%, one year?

Q THE CHAIRMAN: Yes?

A And there are certain additions to the general, these utility assets within the Royalite Oil Company.

Q Yes?

A Within that year, you come along next year and your percentage which you take may be 12%. Now you have a distortion there, you have a percentage then which does not really represent,

reflect the additions which have been made.

Q You take at the end of September 1938?

A Yes.

Q Whatever you did in the meantime, should they not have a certain amount of interest, which is a capital asset, in those utilities, why have they not, they are part of that company which owns them all, they have been paid for?

A If we take, take the cash investment in direct assets and we have that figure definitely and ---

Q THE CHAIRMAN: If you have not given it thought and you care to do so, do not let me rush you into an answer about it?

A I would like to.

Q I would like a correct answer after you considered it.

A I would like to sit down and consider it.

THE CHAIRMAN: All right, you may do so.

Q MR. NOLAN: Then we will come to that again. You were going, when the Chairman made his observations, to another statement which has been already marked and which is Exhibit "110" and it is commonly known as the 5, 10, 15, 20, 25 and 30 year statement?

A Yes.

Q Have you that before you?

A Yes. Before I commence, before I go on to that statement, Mr. Chairman, I would like to make a reference to Exhibit "109" which was filed yesterday.

Q THE CHAIRMAN: Yes.

A It is just a small statement in connection with it; that statement presumes to show the number of years over which, the number of years that the investment was in on the basis of amortizing to December 31st, 1946 and I wish to point out

that, in that statement the direct assets calculation is entirely correct but incorrect with the utility assets, just bringing up the same difficulty which one has now, you are dealing with a different percentage of the total of those assets every year in your capital account, and you cannot set up, there is no mathematical way in which you can set up and make the same calculation of those utility assets as on the direct assets. For instance if you have an amount which represents, if you have 12% of them in in 1925, you cannot say that you have that same amount, that 12% in all the period up to 1946 because your percentage that you actually used in your calculations changes each year with your overhead percentage.

Q THE CHAIRMAN: The $121,024.57?

A Yes.

Q Would not be the correct figure?

A No.

Q For the pipeline?

A No, and I just wish to correct that, and the only calculation which one could make is on the direct assets on account of something of this, with the percentages, and I have a statement now being prepared which will deal with the direct only, the direct assets only, which are the only ones which can be given this treatment and I would like to produce that later, my Lord.

THE CHAIRMAN: All right.

Q MR. NOLAN: Well now turning at once to Exhibit "110"?

A Exhibit "110", I should like to read---

Q The preface?

A The preface.

Q That is the 5, 10, 15, 20 years statement?

A Yes, the 5, 10, 15, 20 years statement.

Q All right, Mr. Taylor.

A It is dated January 7th, 1939.

"Exhibits A and B attached hereto have been prepared applying the same principles as are set out in our report dated January 7th, 1939, and the Exhibits attached thereto. The same comments apply also to Exhibits C and D, except that in the case of these Exhibits a salvage value of 10% for the 5, 10 and 15 year period and 5% for the 20, 25 and 30 year period has been assumed.

We wish to point out that the Income Tax per barrel shown on the attached statements is the Income Tax on the profit actual made in these years and that there should be substituted therefore the Income Tax per barrel which will emerge from such rate as may be set".

In other words the Income Tax figure which is shown is the Income Tax actually paid and one would have to make a calculation of what the Income Tax would be which would emerge from any rate which might be set, it will not be the same amount as the Income Tax which was actually paid. Those are the figures which Mr. Morrison read into the Record just at the conclusion of his testimony a week or so ago, and I think---

Q THE CHAIRMAN: That is because I suppose they are paid on the basis of their 10% depreciation?

A No, on the basis of profits which were made in the past years.

Q MR. NOLAN: Less 10% depreciation?

A Oh yes. Excuse me, no, it would be the profits as shown by the statements, the C1 to C8 statements.

Q MAJOR LIPSETT: Which they have already provided for depreciation?

A Which is providing for the amortization up to 1946.

Q THE CHAIRMAN: Is that not new, was the company not working on a different basis for Income Tax purposes?

A Oh yes, they were working on a 10% basis.

Q MR. NOLAN: 10%, as the Chairman said?

A Yes.

Q And paid on that?

A The company paid their Income Tax on that basis.

THE CHAIRMAN: Yes.

Q MAJOR LIPSETT: The Income Taxes in future which would have to be taken care of would be 22% of whatever--

A Whatever emerges from the rate.

Q Whatever emerges from the rate?

A Yes, that is correct.

Q MR. NOLAN: Now turning to Exhibit A---

THE CHAIRMAN: Of Exhibit "110".

Q MR. NOLAN: Of Exhibit "110", yes my Lord.

A "Statement of Investment, Net Earnings and Rate of Return on various Amortization bases to 100%". Now that is the basis on which the statement in Exhibit, the Court Exhibit "100" is based and as you will remember, my Lord, there was no, that was a calculation of the return of capital in full, there was no salvage value. Now as I understand the statements are going to be used taking the life of the field then there must be salvage value taken into consideration and I think it would be, the statements which the Commission will be considering will be my statements C and D which give that salvage value, so I think we should refer to them; these first two statements were made merely to coincide with the basis which has been adopted in my report.

Q MR. NOLAN: All right.

Q THE CHAIRMAN: Now you are referring to Exhibit "100"?

A Exhibit "C" of "100".

Q MR. NOLAN: Of Exhibit "110".

A Of Exhibit "110", sir.

THE CHAIRMAN: I thought you were referring us back to "100"?

WITNESS: No.

MR. FRAWLEY: Can we be clear, that you do not want us to have any regard to A and B, Mr. Taylor, for the purposes of the rate base?

A It is my intention to work out the rate base only on C and D because there is a dinctinction, Mr. Frawley, that the Commission will be considering the life of the field and its salvage value and then we will have a figure which is ex ctly comparable with Mr. Morrison's figure except that there will be no salvage value, of course, in the 6-inch loop.

Q THE CHAIRMAN: And you say you are making that?

A Yes, that is on the way, it is a calculation which takes quite a little time but it is in hand.

Q MAJOR LIPSETT: So the only difference between A and C, Mr. Taylor, is this question of the salvage value, is it?

A That is the only difference.

Q MR. NOLAN: And C includes salvage value?

A C takes cognisanze of salvage value as stated on the head of the statement, 90% for the period from five years to fifteen years, 95% for the period from twenty to thirty years.

These figures are merely the collection of the net investments, the net earnings and rate of return on the calculations which we have made on the different bases, running from 5 years to 30 years, and they are taken from our work sheets. I do not know the figure - would you wish me to run over these figures sir?

Q MR. NOLAN: Just give me an idea what it is intended to convey. You say amortization basis. That means the period of years, 5, 10, 15, 20, 25 and 30 years?

A From January 1st, 1939. Which is the same period as adopted by Mr. Morrison in making his calculations.

Q Then you take it from the figures as shown in the respective years 1931 to 1938 from your "C" schedule to Exhibit "100"?

A No sir. No, that is not right.

Q From the "A" sheets?

A No sir, they are taken from our work sheets, which have a separate calculation, because your investment varies on each of the different bases.

Q Oh yes.

A All the way through. So that is taken from the work sheets in our office. That is the result.

Q And this is the net investment in each of these years?

A The net investment in each of those years on the basis of amortizing in 5 years from January 1st, 1939, on a 10% salvage value.

Q Then how do you arrive at the net earnings in each of these periods?

A The net earnings we arrive at by the same direct and the same indirect costs as appear on the "C" exhibit

attached to Exhibit "100". But there is a change in the amount of amortization because of the different bases.

Q Because of the different periods yes?

A Yes.

Q Then you show the rate of return in each of these years?

A Yes sir.

Q Then we should read these columns downwards shouldn't we, on the 5 year basis?

A On the 5 year basis. The first figure given is the 5 year basis.

Q Yes, and the rate of return is?

A 7.32%.

Q 7.32% in 1931, 9.38% in 1932, 16.80% in 1933, 25.09% in 1934, 23.76% in 1935, 16,49% in 1936, 43.19% in 1937 and 32.61%, that is for the nine months only of the year ending September 30th, 1938, an average of 23.96%.

Q MR. COMMISSIONER LIPSETT: Can you give us the yearly figure for 1938?

MR. NOLAN: The percentages, my Lord? It would be 42.81%.

A 43.48%.

Q Yes, that is a little different. Now would you run down this first column of 10 years. I observe it is 8.22% for 10 years, and for 15 years it is 8.72%?

A Yes.

Q 20 years 8.96%; 25 years 9.19% and 30 years 9.36%?

A Yes.

Q Is there only that small variation in the rate of return

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having regard to the wide difference in the number of years?used, from 5 to 30?

A Yes sir. That is so.

Q THE CHAIRMAN: Do I understand the more years you take the greater should be the rate of return?

A One would think so, and that is so in that first period. I would like to follow that out.

Q MR. NOLAN: It is not true in these other periods?

A It was a result that really astounded me when I first saw it, because when you come to.....

THE CHAIRMAN: We seem perhaps not to have had that point of view when we were considering the life of the field.

MR. NOLAN: Perhaps we began at the wrong end.

A When you come to 1938, Mr. Chairman, you get a larger return on a 5 year basis than you do on a 30 year basis. Would you like me to explain why that is?

(At this stage there was a short recess).

Q MR. NOLAN: You were going to give the Commission the benefit of your explanation as to the fluctuations of rates of return on Exhibit "C" of Exhibit "110"?

A Yes sir.

Q Will you please direct your attention to that?

A I would like to direct your attention to the period of the nine months, or perhaps we had better take the complete year 1937, which is the third column from the end.

J. W. Taylor.

Q THE CHAIRMAN: Yes?

A On the 5 years' basis we find that the rate of return is 43.19%. Following down the line it gets a smaller percentage, the longer number of years, until you arrive at the 30 year basis when the rate of the return on the 30 years' basis is 35.18%, as compared with 43.19% on the 5 year basis.

Q MR. NOLAN: The converse is true of the 1931 column?

A The converse is true in 1931, but not in such a spread. In 1931 the rate of return on the 5 year basis is 7.32% and on the 30 years 9.36%. Perhaps I can explain how that comes about, Mr. Chairman. In 1937 we have working in a cumulative way the provision for amortization. That is to say the calculation is on our net assets after providing for amortization, and we have an accumulation up to the end of 1937, an accumulation of our amortization up to 1937 over all the years back to 1925, which has been working as I say in a cumulative way. Now in 1937, in the profit part of the picture, the only reflection we get of the difference in amortization as between the 5 and the 30 year periods, is the difference within that year. The only difference in your amortization charge is the difference within the year. That is to say on the 5 year basis you have a larger charge for amortization against your profits, a much larger charge than you have on the 30 year basis, in your profit, but you have that reflection on for only one year. Whereas in the capital section you have an accumulation of that difference in charge right back

to 1925. That is to say that you have taken off your assets for the purpose of making your calculation of return on investment a smaller amount for the larger number of years.

Q Yes?

A And that gives the effect which is opposite to what one would expect. The situation in 1931 is the situation one would expect, but through the accumulation over almost 8 years, your situation reverses itself and you have a higher rate of return on the 5 year basis in 1937 than on the 30 year basis.

Q MR. COMMISSIONER LIPSETT: You have not followed out your own year, 1946, I notice, in any of these calculations?

MR. NOLAN: No. You see, Sir, what was done was this, Mr. Taylor prepared a report and in that report, according to his judgment, he put in a period which he thought was proper in the circumstances. Then we were requested by the Commission to prepare statements on these varying figures from 5 to 30, which we did. Now this is not a part of Mr. Taylor's Report. This is an answer to a request of the Commission.

Q MR. COMMISSIONER LIPSETT: Yes, I know that.

Q You have not followed out your own Report in any other figures at all?

A No sir. The only the figures taken from my Exhibit "100", "C" statement there, 1 to 8, the only figures taken into this are the direct and indirect costs. Then the amortization is based on this 5, 10, 15, 20, 25 and 30 year basis. I have ignored the provision

for amortization which is in my first Report.

Q Would it be convenient and possibly desirable, Mr. Taylor, to make your picture and your evidence, to bring it to its logical conclusion, that you should give us a figure based on amortization for the period ending 1946?

MR. NOLAN: That is what we have done, sir. Is that not in Exhibit "A" of Exhibit "100"? The first sheet on Exhibit "100" is your main Report.

A No, that is not on a 1946 basis. The only difference between those "A" and "B" statements and "C" and "D" is that in the one case, in the case of "A" and "B" no salvage value has been taken.

Q I am talking about Sheet "A" of your main Report, Mr. Taylor. Exhibit "A" of the main Report?

A Yes sir.

Q Exhibit "100". What Mr. Commissioner Lipsett wants to know is have you worked out this rate of return on your own figure of December 31st, 1946?

A Yes, that appears on Exhibit "A", attached to Commission Exhibit "100". That is the working out of the return on capital on the basis of 1946.

MR. NOLAN: Exhibit "100" is Mr. Taylor's main Report. On the first page of that, being Exhibit "A", there is the basis used being 31st December, 1946, and he shows his rate of return there as being 41.......

Q THE CHAIRMAN: 41.99 is it not?

A Yes sir, 41.99 from 1937.

MR. NOLAN: I think that is the figure Mr. Commissioner Lipsett wants?

A Yes, that is the figure.

Q MR. COMMISSIONER LIPSETT: On what basis was the amortization written off, on that Exhibit "A" then, Mr. Taylor?

A That is amortizing everything up to December 31st, 1946.

Q And is that taking that back to 1925 or only starting in December 1931?

A It takes it back to 1925. All the statements do that. You must go back to the beginning in any amortization calculation.

Q MR. NOLAN: But there is a difference, Mr. Taylor, that is in your Exhibit "A" of Exhibit "100", and in the sheet to which you have just referred, being Exhibit "C" of Exhibit "110", the salvage value is used in the latter case and not in the former?

A That is the difference.

Q So that the figure of 41.99 which you are giving now to the Commission does not take into consideration salvage value.

A That is correct.

MR. COMMISSIONER LIPSETT: It is not really comparable then?

MR. NOLAN: It is not comparable to that extent.

Q That does make a difference does it not?

A Yes sir.

Q THE CHAIRMAN: And is that difference ascertainable.

Q MR. COMMISSIONER LIPSETT: This Exhibit "A" also takes in the working capital?

A No, there is no working capital. The working capital is

not amortized. It is one of the fixed assets.

Q That is included in Exhibit "A", and is it dealt with in this Exhibit "C" of Exhibit "110"?

A Yes sir, the working capital is in both these.

Q In both?

A Yes sir, at the same amount.

Q So the only difference in principle is the salvage?

A That is correct.

Q And can you without much trouble give us an exactly comparable figure based on your date?

A Taking the salvage value.

MR. NOLAN: Well a comparable figure could be obtained?

A Yes sir. A comparable figure with the figure in Exhibit "A".

THE CHAIRMAN: "A" of "100"?

A "A" of "100", yes.

Q MR. NOLAN: What else have you to say about the fluctuation in the rates of return, Exhibit "C" of "110"?

A There is nothing further to add. I would like to draw attention to that figure in the right hand column, weighted average number of years capital employed, which is a calculation based on the Exhibit "109" which I discussed when I first came on this morning. That figure of 10.17 years cannot be taken just as it stands. I did say at that time I would have a calculation made up dealing with the direct assets only on account of the obligation of bringing in the indirect assets. I would like to turn to that now if I may.

THE CHAIRMAN: Very well.

DOCUMENT IN QUESTION IS NOW MARKED EXHIBIT "115".

MR. NOLAN: This is an explanation of the former exhibit "109"?

A That is right.

Q I think you have explained it now, You have taken the direct assets and you have arrived at a percentage of utility assets?

A That is correct.

Q And instead of the old figure of 13.171 years, you have a new figure of 14.8375 years, which is the weighted average number of years during which the investment and indirect assets is employed?

A Yes, indirect assets, yes sir.

Q On your basis of 31st December 1946?

A Yes sir.

Q It requires no further explanation.

(At this stage the Hearing was adjourned until 2 P.M.)

....

(Go to Page 2861).

(EXAMINATION OF MR. TAYLOR CONTINUED BY MR. NOLAN)

Q Mr. Taylor, I wonder if just to begin with---

A I would like to go back to the Exhibit which I call the "114" Exhibit, I think it should clear first the suggestion you made that some calculation should be made as to how the indirect assets, that is the utilities and the proportion which is considered as vested against the pipeline department might be considered in the fixture of the current cash account which is shown in Exhibit "114".

Q THE CHAIRMAN: Yes.

A That is the one with all the red figures in it.

Q You are referring to Exhibit "110" first?

A No, "114", and coupled with Exhibit "109", I would like you to have "109" before you.

Q MR. NOLAN: That is the one with the percentage of assets on it; now Mr. Taylor.

A On Exhibit "109" the first column of figures shows the percentage of utility assets, the additions year by year to the utility assets at the percentages in respect of which they are considered in your statement from 1931 to 1938 as being applicable to the pipeline department, that is to say, we take the total additions of these utility assets and we take the overhead percent and then for the five years prepared by the company, which is operative 10%, which is approximately the percentage of the indirect expenses which are applied, the first four or five years of my presentation, so that we have here a total from 1925 to 1938 an amount of $121,024.57, which represents what is considered in our capital figure of being the proportion of the total utility assets and those are the additions, the same proportion of

the additions for the whole period back to 1925, so that that amount of 121 thousand dollars is related by percentages to the proportion that we consider is the proportion of the investment which belongs to the pipeline department. One might say the degree in which the pipeline department uses those utilities.

Q THE CHAIRMAN: Yes, so that turning to Exhibit "114"?

A Yes.

Q You would add to the figures $1,465,150.56, the figure $121,024.57 on Exhibit "109"?

A That is not quite correct, sir, because the percentage in which you use the utilities fluctuates from year to year, Perhaps I might put it this way, sir, that this is, this 121 thousand is the amount which the pipeline department should have provided out of its amortization and by way of amortization of these assets, this proportionate amount of the total.

Q Well now what I was trying to get at at one stage was that they end up in 1938 with a certain amount of direct assets and a certain amount of cash in the bank?

A Yes.

Q I gathered that you might add to that a certain amount?

A Yes.

Q For indirect assets?

A Yes.

Q Which they own?

A Yes, if---

Q And what is that amount?

A Well that amount is the amount of $121,024.57 at which we are looking, if we take, if you look down the column, cash

invested in direct assets and then if we add, Mr. Chairman, add to that amount a corresponding amount in the same year, take in 1925, the addition would be $8,019.93, 1926 we would add $889.63 to the $10,769.62, and going along down the line, we would have $1,465,150.56, plus $121,024.57, as representing the cash invested in direct and indirect assets over this period.

Q MAJOR LIPSETT: As against that, Mr. Taylor, as the Chairman points out would you not have an interest amounting to $121,024.57 invested in the indirect assets as your fair proportion?

A Yes, you have, and that is taken cognizance of in the net investment account, in that in each year there the direct investment, investment in direct assets, a percentage for the utility assets which you use and that is the overhead rate.

Q Yes, but that means, does it not, that you had paid that much money in those particular years for indirect assets?

A That is that there were certain additions made to the direct assets by the company, the direct assets of a whole, and we take those additions and applying our percentage we use in our capital and we get these figures that total $102,000.

Q 121 thousand dollars you mean?

A 121 thousand, this 121 thousand dollars.

Q Yes, and that is the money which you have paid out from the pipeline department for indirect assets in your accounting?

A Monies that we should have paid out.

Q MR. NOLAN: That is it.

A That we should have paid out to enable the company to meet

[illegible] ver this [illegible]

[illegible] would [illegible]

[illegible] inv[illegible]

[illegible] direct assess[illegible]

[illegible] investment in [illegible] you use one [illegible] which [illegible]

[illegible] that you [illegible]

[illegible] particular forms [illegible]

[illegible] those conditions are [illegible]

their additions, meet their proportion of the additions.

Q MAJOR LIPSETT: And you have charged that amount in this account each year as against profit?

A That is right, yes, our amortization in the cash statement includes a provision for amortization on the indirect assets.

Q On the indirect assets?

A That is true.

Q So if you get credit for this 121 thousand dollars as money you have invested, you have acquired in lieu of that, that percentage interest in the indirect assets of the company, have you not?

A Well that is taken care of I think by adding to the one million four hundred and sixty-five thousand, the total direct assets, the $121,024.57.

Q Giving you this figure of $1,586,175.13 which you show in Exhibit "109"?

A Giving which, I do not follow that,

Q The total of that 121 thousand and the 1 million four hundred and sixty five thousand?

A Yes.

Q Gives you this figure shown on Exhibit "109" as $1,586,175.13.

A That is correct, sir.

Q Then that is represented, is it not, in property value, first of all by your direct assets and secondly by your equity?

A By the proportion.

Q In the utility?

A Yes, that is right.

Q If you take in the money must you not add on to the value of your property the percentage of these?

A Yes, that is correct and do automatically get that result if

we were to take this cash investment in direct assets and add on these amounts year by year. Of course we would arrive at the same place. We would arrive at $1,586,175.13.

Q What the Chairman was putting to you and what I was also trying to put to you was, would the total assets then to-day be the figure which you have given in Exhibit "114" plus this equity in the indirect assets?

A That is correct, sir.

Q Increasing the actual value that much?

A Yes. Now perhaps if we follow that out and go to the attachment to 114, sir, I think we can cover this point. Now this memorandum attached to 114 shows the provision for amortization of the indirect assets which are charged against the profits which we show on 114, this $75,453.55 which we have charged against our profits in 114. Now if we take our $121,024.57 which we should have supplied to meet our proportion of the additions which were being made to the utility assets we would have required $121,024.57. We actually did supply this $75,453.55, so we handed over an amount which was short $45,571.02 of the amount which we should have handed over to enable them to meet our proportion of the additions which they were making year by year from 1925 to 1938.

Q THE CHAIRMAN: Yes, so that your assets direct and indirect?

A Yes.

Q As shown on Exhibits "109" and "114"?

A Yes.

Q Are the direct assets of the company less the 45 thousand dollars odd which the pipeline department did not put up?

A Yes, or if we take the balance of $410,489.08.

Q Yes.

A Then from that we deduct $45,571.02 which we were short, if we look at it that way, and we have a balance of $354,918.06 in our indirect assets amortization reserve.

Q MAJOR LIPSETT: Then to that figure you would have to add the whole 121 thousand, would you not, because if you paid this 40 thousand out of your cash balance, you would then be entitled to an equity in the indirect assets of 121 thousand?

A Yes, there would be an addition of 121 thousand to the one million four hundred and sixty five.

Q You get the same result in effect, Mr. Taylor, would you not, if you just added this $75,453 to the figures which you have given on the first page of 114?

A To the 410, correct.

Q Yes, or to the one million four hundred and sixty five thousand?

A Yes, if you add the 121 thousand to the one million four hundred and sixty five.

Q THE CHAIRMAN: And subtract the 45 odd from the 410?

A Subtract the 45 from the 410, and then we get 364 thousand dollars odd, which is short of our indirect assets amortization reserve, in other words, all of our balance, all of our remaining balance would be spoken for by the amortization reserves.

Q In the results you take, taking into account the indirect assets, you add about 75 thousand dollars to your total cash position today, somewhere around there?

A Yes, including cash and assets.

Q Yes.

A Yes.

Q MR. NOLAN: Then, Mr. Taylor, if you look at Exhibit A of Commission Exhibit "100", I observe under date of September 30th, 1938?
A Yes, sir.
Q The portion of investment in utilities assets and service units applicable on a direct operating labour basis is the figure of $324,252.85?
A Yes, sir.
Q And the figure that you have just been discussing.....
THE CHAIRMAN: Where are you, Mr. Nolan?
MR. NOLAN: Exhibit A of Exhibit "100". It is, perhaps, unfortunate we called these "Exhibits" but you know what I mean.
A Exhibit A of Exhibit "100"?
THE CHAIRMAN: Yes.
MR. NOLAN: If you look under date September 30th, 1938, I find that we set out proportion of investment in utility assets and service units, $324,250.85. The figure you have just been discussing was $121,024.57?
A That is right.
Q But I do not quite see how those two figures are reconciled? Which figure is right?
A Which figure? The figure in Exhibit A as of September 30th, 1938 is arrived at on the basis of indirect costs.
Q You mean it is arrived at, using a percentage?
A Using a percentage.
Q Of indirect costs?
A Yes, and some percentage of the total utility assets.
Q And the percentage is 28.8996, as a matter of fact?
A That is correct.
Q And that is what gives you the figure of $324,252.85?
A That is correct.

J. W. Taylor.

Q I understand that. Have you anything more you want to say about that?

Q THE CHAIRMAN: Which is the accurate statement, would you say you approach it in two different ways. They must have had a meaning when it was put in as proportion of the investment in utility assets....

Q MR. NOLAN: If you look at Exhibit "109", Mr. Taylor, you see the total of your percentage of utility assets is $121,024.57?

A Yes, sir.

Q That is worked out on varying percentages during the years between 1925 and 1938?

A That is correct.

Q Then why does it appear in Exhibit A of Exhibit "100" that the proportion of investment in utility assets is $324,252.00?

A Because the percentage in that period is higher than the average.

Q Because of the difference in the percentage used in that period and the percentage used in the period, the other period, which is 28.8996?

A That is correct.

Q And the percentages used in the periods set out in Exhibit "109" are in varying amounts, as we have seen?

A Yes.

Q 15% in 1937, 12% in 1936, 10% in 1935, 10% in 1934, 9% in 1933, 11% in 1932 and 10% in 1931. That would be an average of about 10%?

A Roughly.

Q Roughly? 10%?

A Yes.

Q And by using the 28% we get a figure of $324,252.85?

A That is correct.

Q Now, I want you to look, if you will, please, again for one moment at Exhibit C of Exhibit "110"?

A C of Exhibit "110"?

Q Would you please look at the year 1937, just to see if we can make that fluctuation a little more clear.

Q MR. COMMISSIONER LIPSETT: The total of September, 1938, the figure on Exhibit A of Exhibit "100", and in Exhibit "109", Mr. Taylor, practically corresponds. The total of direct and indirect in Exhibit A of "100" is $1,551,573.26?

A Yes.

Q And the total in your Exhibit "109" is $1,586,175.13?

A That would be the figure we add $121,000.00, yes.

Q So apparently when you get out the detailed statement, the actual direct assets were greater and the percentage or amount in the indirect assets was less, but the total is approximately the same?

A Yes, that will be so.

MR. FRAWLEY: On the same date?

MR. COMMISSIONER LIPSETT: Yes.

A At September 30th, 1938.

Q Yes. This Exhibit "109", is it made up to September, 1938?

A There is a factor there, sir, which makes it not quite comparable. In this figure in direct assets September 30th, 1938, of $1,227,320.41, if you look at the bottom, what we call the reconciliation, of Exhibit "114". We take the $1,227,........

Q Exhibit "114", is that?

A Yes, sir, "114". The figure is $1,227,320.41, and that is the figure that is used for the purpose of the capital,

and as we note, it is the capital at the beginning of the year plus half the additions for the year. Now, in the reconciliation in order to get at the position at the end of the year - not to the end of the year but September 30th, we add back half the additions, and we arrive at the figure of $1,465,150.56, which corresponds with the figure above as the total cash investment in direct assets up to September 30th, 1938. I think that is the figure that is putting us out of alignment.

Q In answer to Mr. Nolan's question, is it your opinion then that the figure of $324,252.00 shown as utilities in Exhibit A of "100", or the figure of $121,024.00 shown in Exhibit "109", which of those do you say is the correct figure?

A In the $121,000.00 figure we take an average over all the period beginning 1925, whereas at September 30th, 1938, it is the figure arrived at as all of the specific.....

Q Based just on the one year?

A Based just on the one year.

Q And the other is correct over the whole period?

A Yes.

Q MR. NOLAN: Would you mind looking at Exhibit C of Exhibit "110", for a moment, please. Have you it before you?

A Yes.

Q If you have Exhibit C of Exhibit "110" before you would you be good enough to look at the year 1937. Now, looking at the column Year 1937?

A Yes, sir.

Q I draw your attention to the diminishing rate of return during that year on the different amortization bases.

Now, Mr. Taylor, try and explain the reason for the peculiar fluctuations, looking at it from the five year point?

A Yes, sir.

Q I see that there is a net investment there in round figures of $663,000.00?

A Yes, sir. That is true.

Q Now, that is approximately $260,000.00 lower than it is for the thirty year period?

A That is correct.

Q Which shows at $927,000.00?

A Yes, sir.

Q And that, as I work it out, is a difference of about 40%?

A Roughly 40%.

Q In the net investment figure?

A In the net investment figure. That is a reduction in the net investment figure.

Q Now, looking at the earning position?

A Yes.

Q I find that the earnings or profit in 1937 from the five year period is $286,000.00?

A That is correct.

Q And that in the thirty year period it is $326,000.00, a difference of $40,000.00?

A Yes.

Q Which is approximately a difference of 14%?

A That is correct.

Q So that while your profits have varied by 14% your net investment has varied by 40%?

A That is correct. One up and the other down. The profits up and the investment downwards.

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Q No, that is not right, Mr. Taylor. Our investment has gone up from $660,000.00 to $927,000.00?

A Yes, sir, that is correct. They both go up but in different ratios

Q They go up in different ratios of approximately 14% to 40%?

A Yes, that is correct.

Q And that is what brings the diminishing rate of return in the various periods set out?

A Yes, sir, that is the factor which works.

Q I hope that my feeble efforts have made it a little clearer. Perhaps, I may give a little evidence for a moment. What I was trying to show was that between the five year period and the thirty year period in the year 1937 we find that our net investment goes up from $663,000.00 to $927,000.00, which is an increase of about 40%. In that same period the profits go up from approximately $286,000.00 to $326,000.00, which is a difference of 14%, and it is by reason of the different percentages.... no, put it another way, it is because the net investment has increased by 40% and the earnings have only increased at 14%, which brings about the diminishing rate of return. Is that so?

A Yes, a diminishing rate the longer period you go.

Q But as between the five and the thirty years?

A As between the five and the thirty years, yes.

Q THE CHAIRMAN: In terms of the kind of rate we will ultimately have to think about, would you expect to get a higher rate from the Utility Board, say, a higher rate fixed if the life of the field was fifteen years than if it was five years - to be concrete?

A If it were five years you would want a larger rate,

because you would have to amortize over five years.

Q Yes?

A Than if you were amortizing over fifteen years.

Q So that the longer term that is determined as the useful life of your investment the less your rate?

A The less your rate.

MR. NOLAN: That is something I never realized before.

A Which is quite the contrary to what the figures show, which is an odd thing.

Q Now, Mr. Taylor, you were going to discuss at that point your calculations in the Exhibit we put in as Exhibit "110" and contained in Exhibit D of that "110"?

A Exhibit D of "110", Yes,

Q What is that?

A It is a statement of the net profit and costs per barrel on various amortization bases to 90% for periods from five years to fifteen years, and to 95% for periods from twenty years to thirty years. And we have the figures for each of the seven years ending in 1937 and for the nine months ending September 30th, 1938.

Q Yes?

A The cost per barrel includes the direct and indirect costs per barrel as shown by the C Exhibits to Commission Exhibit "100", that is my report.

Q Yes?

A And plus an amortization charge based on a five, ten, fifteen and so on years.

Q Yes?

A And with salvage valuations of 10% and 5% as noted on the heading of the statement.

Q Yes?

A The Income Tax per barrel which is included in this statement, and which is referred to in the memorandum that we place in front of the statement.

Q Yes?

A Is the Income Tax on the profit actually made in those years and that there should be substituted therefor an Income Tax per barrel which will emerge from such rate as may be set. Now, these figures are all in per barrel. Suppose we take the first five years from January 1, 1939. I do not know whether it is necessary for me to read over the figures?

Q No, it won't be necessary. I can help you with that. The cost per barrel is 9.11 and the Income Tax 2.37 - a total of 11.48, leaving a profit of 9.28¢?

A That is the average over the seven years and nine months.

Q That figure of 9.28¢ on the ten year basis becomes 10.10¢?

A Yes, sir.

Q And becomes 10.53¢ on the fifteen year basis ?

A Yes.

Q 10.74¢ on twenty years, 10.94¢ on twenty-five years, and 11.08¢ on thirty years?

A Cents per barrel.

Q On a thirty year basis?

A 11.08¢ per barrel on a thirty year basis. A statement of the varying rates of return is now being worked out, which I will file supplementary to this.

Q Now, I think that concludes all that you and I have discussed. Was there another point?

A There is nothing more.

Q Thank you, Mr. Taylor.

. . . .

(CROSS-EXAMINATION OF THE SAME WITNESS BY MR. FRAWLEY:)

Q Mr. Taylor, you had to depart from the books yourself, hadn't you? You departed from what the books had done with depreciation?

A That is correct, yes.

Q You departed from what the books had done in respect to allocation of expenses?

A There had been no allocation of expenses to the pipeline department. There had been in an approximate way, there had been certain allocations made, and I understand, I was not in Calgary at the time, but I understand that there were certain allocations on the books and those were discussed between the representatives of our Calgary office and Mr. Morrison, and the Company, I think, and it was agreed that those allocations would be ignored.

Q Would be what?

A Would be ignored.

Q Ignored, yes?

A The allocations that had been made by the company as not being studied allocations.

Q So that both of you - but I am speaking of you for the moment - you were compelled in your own good judgment to depart from what the books of the company showed with respect to the allocation of expenses?

A With respect to those allocations, yes.

Q So that you did find and you have found during the course of the Enquiry that it is quite a separate thing to present a case to the Commission as distinguished from the manner in which this company kept its books for its own purposes?

A I did not catch that.

Q I say you now appreciate it is quite a different matter to break down these costs, and set them up in a fashion suitable for the purposes of this Commission, as distinguished from the manner in which the company kept its books?

A Yes, I think it is proper to use judgment as to whether they had been properly set up or not, and as to whether the company's allocation gave the proper results for purposes such as this.

Q You did not think they had and you had to do it yourself for the purposes of this Commission?

A That is correct.

Q And really, your object has been, your aim has been, as I understand, and so has been Mr. Morrison's, to segregate and separate out the pipeline division from the rest of the company?

A That has been the idea.

Q And to endeavour to place upon the pipeline company its fair share of the expenses of this business, both indirect and direct, just no more nor no less than that division should bear?

A That is correct.

Q For that reason I want to discuss with you what the effect is of the allocation which you have adopted. I am concerned not so mu h with what the books said about it, perhaps, but what the fact was. I think you said yesterday, and the fact apparently is, you will probably agree with me at once, that when the Absorption Plant is being built one of the first things that happens is that a fuel gas line is run out to that Absorption Plant for construction purposes?

A I do not know what the mechanical operation is. I would not be able to speak as to that.

Q And supposing a water line too is run out?

A Probably.

Q To take part in that construction?

A Possibly.

Q The Forge and Machine Shop is immediately made available pretty generally to the construction of that Absorption Plant?

A I would take the word of operating men that that would be so. I would not know as an accountant. I would not know that.

Q But you would suppose it was?

A That the Forge and Machine Shop.....

Q I take it from your evidence a day or so ago in connection with the drilling of wells, that the Forge and Machine Shop becomes a pretty important service unit?

A That is so, yes.

Q I naturally want to take some things that, perhaps, you and I might, without much guessing, agree would be needed in those construction departments?

A Yes.

Q And dealing again with the fact only and not with the bookkeeping, but if the fact is, therefore, that during construction the service units are in fact used in the construction department?

A Service units as opposed to utilities? When you say service units do you mean the department that have the charges cleared and charged to the job, as it were?

Q No, I am not trying to think of it in departments. I am trying to get it down pretty concretely to what actually

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happens in fact. I say the Forge and Machine Shop, which we call a service unit or a utility, I do not know which.

A. Yes

Q But that, in fact, goes into operation for the assistance of the Absorption Plant?

A Yes, sir.

Q Being built, and the wells being drilled?

A Yes, sir.

Q If that is a fact why should not the Absorption Plant Department, or whatever that department is, and the Drilling of Wells Department, bear in fact a portion, be it great or small, of that utility and service unit expense?

A Any jobs done for Drilling of Wells by the Forge and Machine Shop is charged directly to Drilling of Wells. If there are any charges to capital construction of the Absorption Plant, as you suggest, the charge goes out and it is charged.....whether it is capital or operating, the Forge and Machine Shop sends its charge and it is reflected on the books.

Q Now, we see from Exhibit "106", your Exhibit "106", there is an item of $2,675.53, which I think you said was left over from the Forge and Machine Shop. First of all, what does that mean exactly?

A What is the amount, sir?

Q $2,675.53. What is that first?

A That is the resulting balance, after all the work has been charged. In other words, that is not a reflection of the total transactions that went through that account. We had charges for wages and for materials.

Q Yes, all right. I think I understand that. But what happens to that?

A Into the Forge and Machine Shop go the wages of the Forge and Machine Shop and raw materials they use and part of the overhead. This balance is not representative of the total charges that go through that account.

Q No, this is a resulting figure?

A This is a resulting figure. Now, I will g[illegible] side of the picture, the credits that go to that account. Credits for work done for drilling wells; work done for capital work on Absorption Plant and any capital work at all, and any operating work. It all goes through that account and rests under capital assets or against operating, as the case may be. That is Forge and Machine Shop.

Q Now, what happens to the $2,675.53. Where do you put that?

A That goes into indirect costs. You might call it the profit that was made by the Forge and Machine Shop, because it charged out more than what it actually spent.

Q Can we say then that the Drilling of Wells Department was in a sense overcharged?

A Oh, to a very small amount. I should imagine....well, I do not know the figures that went through there.

Q Take any small percentage then that is fair, you say they were overcharged?

A Overcharged, yes.

Q And why should not they get credit then?

A We might break up that $2,300.00. Supposing there was $100,000.00 went through on both sides of the account, we would have about 2% to credit back to Wells Drilled. 2% of this, a proportion of this.

Q Then you are saying now that some small proportion of this surplus figure should be credited back to the Drilling of

of Wells Department?

A In order to put the operations of the Forge and Machine Shop on a cost basis, yes.

Q Then the same thing applies, does it, to all of the items there, Trucks and Tractors, $2,551.32?

A Yes, sir.

Q And Ditching Machine Expense, $1,674.00?

A Yes, sir.

Q And the same thing with respect to all these items that appear in black?

A Yes.

Q The Used Material Warehouse?

A No, there is a difference so far as the figures that are in black are concerned. Take the Water System.

Q Yes, tell us about that?

A The Water System evidently made a loss and by the same token as we would credit back some profits so we would charge the loss, in order to put us on a cost basis.

Q Yes, the same thing?

A Yes.

Q Then, if I understand the manner in which you have set up your account though, Mr. Taylor, you do not allocate to what you call the Non-Revenue Producing Departments the department that builds the Absorption Plants and the department that drills wells, any portion of the indirect costs or any portion for administration expenses. Utilities and Service Units Expense?

A As I have explained, there has already been a charge come from the Forge and Machine Shop and so on, and that rests in the books.

Q As I understand, Mr. Taylor, that is a direct charge?

A That goes in as a direct charge.

Q But then there are a lot of indirect, as you have listed them on Exhibit "106" for us, you have broken this down for us, as we asked the other evening?

A Yes.

Q I will deal with Exhibit "107" in a minute. But dealing with Exhibit "106", these are the indirect costs which appear in your Exhibit "100" in C8, as I understand?

A That is correct.

Q C8?

A Yes.

Q Which you went over at great length the other day, and very fully, that is for the period ended the 30th of September, 1938, and we find a figure of $132,560.03?

A That is right.

Q And you told us when you were going over Exhibit C8, under your system of allocation as distinguished from Mr. Morrison's, the Drilling of Wells Department - taking that as typical - had allocated against it no portion of the indirect expenses of all the utilities and service units expenses and no portion of the administration expenses?

A Yes.

Q And, as I understand it, that was the cardinal difference between your system of allocation and Mr. Morrison's, that is right, is it not?

A That is correct, sir.

Q Then I would call your attention to what the fact is with respect to the use of those service units and utility units, the actual fact of their being used by the Drilling of Wells Department. Now, you say a certain proportion of it should, under the existing facts, be allocated to that

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J. W. Taylor.

Drilling of Wells Department?

A No, I would not say so, sir.

Q You would not say so?

A Not in my estimate.

(Page 2883 follows.)

[illegible]

J.W. Taylor.

Q Well, then, what is the distinction between that, I just want to understand, why do you say "Not" when a moment ago you said a small portion of it should go back?

A Well, that is to put them on a cost basis. I think when one averaged up the periods which would go back and the credits which would go back, that there would not be very much in it either way.

Q Then the distinction is, you say it would appear as if some small portion should go back on one side of the ledger and then some more on the other side of the ledger, and it all evens up?

A I believe that might be the practical result, easily.

Q Trying to do as well as we can to allocate those costs to the existing facts then I suggest to you the effort, and the system which does allocate to the Drilling of Wells Department a portion of the service units and the utility units which are in fact used, would commend itself as being a more exact way of dealing with those costs?

A Well, I would like to distinguish between those, I would like to distinguish between those service departments which are made a subject of job orders, you might say, or which period it occurred, as the work is done, and these which I call the utility assets, where we have a total expense which sits there, the expenses for the nine months sits there and is not allocated at all because in the case of those that do charge or do job orders, presumably the proper charges as between capital and operating, have been given effect to.

Q Yes. Well, my attention is called to the fact that there is a balance left over?

A Oh, there is a balance left over.

Q That has to be dealt with?

A Which, if you are going to put these machine shops and so on, on a cost basis, to be strictly accurate one should analyze all the jobs which went through there and divide them between capital and operating and in order to put the operation on a cost basis should take some credit back.

Q And then there would be no distinction then made between capital departments and operating departments under that?

A Oh, there would be a distinction, the capital department would get back its pro rata.

Q It would get its portion?

A Yes.

Q Now, that is being very frank and very fair, Mr. Taylor. Now, in effect what you are saying is that there is a reason then for allocating to the capital departments, as you call them, the Drilling of Wells Department, a portion, - in whatever bookkeeping way you do it is quite beyond me, but it would be fair to allocate to the Drilling of Wells Department, keeping to that, some portion of the utility expenses, the general utility expenses incurred by the company and the general service unit expenses?

A No, we were talking of the distributing back of the profits. This, taking.....

Q Or losses?

A Take the Forge Machine Shop with its profit of $2675.53.....

Q Yes?

A I would agree with you that one, perhaps, should analyze all

the charges which went through that account, discover what proportion was charged to capital and what proportion to operating.

Q Yes?

A Supposing the proportion is 50-50, well capital and operating should each get credit in this case of $1387.74.

Q Yes, well really then, that is still another basis from the one which you have included in your submission?

A Well, that refinement may be carried out.

Q Well, it may be small in degree, but it is essentially still a different method of allocation than the one you have actually used?

A It is not, I would not give it such an important name as a difference of allocation......

Q A variation of the one you have used?

A It would be a variation. Let me put it this way, I presume that these charges are set up so as to just clear the expenses of these departments. I know in any other concern that is what happens, they aim to clear the costs, and you may have good results and end up with a money profit, as is the case here, and one might go to a refinement, although in my experience it is not done, a refinement of going back all over the transactions for the year in order to put back where it belongs the molecule of profit which might be left, or lost.

Q Mr. Taylor, I put it to you again as I put it in the beginning, all I desire to do is to assist the Commission, on putting on the pipeline division all, no more than but all of the share of the total expenses of the Royalite Oil Company in its service units and its utilities that that pipeline division should bear, and I gathered from the

beginning with respect to these indirect operating costs, that is the residual balance in the service units, and the actual expense with respect to the utility units, that no proportion of those expenses had been allocated to the Drilling of Wells Department, and I inferred from that, that none having been allocated to the Drilling Department, that more falls on my department, the pipeline department, that is a reasonable inference, is it not?

A No. Answering that question, Mr. Frawley, I must go to my reason, the reason that I think there should not be a pro ratio labour basis distribution of capital charges. The reason which I have already read into the record twice. The pipeline department is, I would rather, let us take the operations of the Royalite Oil Company as a whole, there are certain minimum expenses in the way of indirect expenses and administrative expenses, annual fixed charges, one might say, that go on from year to year, expenses that would have to be borne whether there are capital expenditures or not. Now, the company is in the business of producing oil and running the oil through the pipeline. It is not in the business of making capital expenditures either, that is, it is not part of its business, and if one has an expense, take an administrative expense of $100,000.00 a year, say, and $100,000.00 in the next year, in one year we have no capital additions , and in the next year we have capital additions to the extent of 50% of our payroll, those expenses would have been incurred in any case, fixed expenses, that you cannot get away from, administrative salaries, taxes, a minimum amount which must be spent in running these utilities in the interests of producing oil and transporting it, a certain minimum

amount which you are going to have to spend whether you are having capital additions or not, and taking two years when those amounts are exactly equal, one year you have a capital payroll of one-half your total payroll, under the system of distributing the capital expenditures you take one-half of those expenses and you capitalize them with the result that your profit is boosted in that year by 50% of that amount. The next year you have no capital additions and your operating, your fixed expenses go back to normal and any profit and loss account of any concern should reflect the two operating profits and I think they should not be fluctuated back and forth by the question of whether capital expenditures are being made or not.

Q Now Mr. Taylor, I understand that and for my part I am quite willing that you should keep your books and set up your balance sheets in any way you like, I do not say I agree with the proposition of yours that there is a certain minimum expense but passing from that for the moment, I am concerned with the facts of whether or not the boiler plant expenses for instance, any portion of that $19,000 which you have for the nine months ended 30th September 1938, whether any portion of that $19,000 was incurred by reason of the fact that some of that boiler plant expenses was used to supply steam to run out to the wells, and I suggest to you that if that, of course it was as a matter of fact and that if it was then, and at the same time it was supplying energy for pumps for Mr. Coultis' pumps, I may be doing all sorts of things, but speaking practically to that boiler plant, and what it was doing, I submit to you then, doing different things for different

branches of this company, that if at the same time we could imagine steam lines going out from the boiler plant and we could imagine one line going out to the wells and another going out for Mr. Coultis' utilities, I suggest to you, the accountants should be able to work out some scheme, how you keep your books, how you dislike capitalizing the utilities, putting that all to one side, I want to know why it cannot be calculated that some portion of that steam line going out to the drilling of wells should not be charged to the drilling of wells department, because my interest in it is that the more you charge there the less you will charge to my pipeline department and that seems to me fundamental, and why do you disagree with that from the standpoint of the accounting, why should not the accounting figure in with the facts?

A I disagree with it on the basis of the study I made of the situation as to the fluctuation of those expenses in years when there were capital expenditures going on and when capital expenditures were not going on. I think I might refer to the Exhibit if I may---

Q. I understand all about the fluctuation, I will give you an opportunity of reading it into the Record again if you like, but all I am concerned with, as I say again, why your bookkeeping methods cannot accord with the facts and let the operation and all that sort of thing abide the results, if the fact is, Mr. Taylor, that the service units and the utility units are being used in the drilling of wells, now frankly I want you to make any explanation you can but at the moment I find it almost impossible to understand why it cannot be reflected in the books, especially when we are now

should not be charged to the building

for the first time making these arbitrary divisions, because we are both agreed we want to put on the pipeline division no greater share of the expenses than it should properly bear?

A Well I would say as to that, our main purpose is to arrive at a proper operating profit of the pipeline division.

Q No not profit but operating costs first, that is the first step, is it not?

A Proper operating costs?

Q Let us keep to that and let the profit abide, the amount of profit I presume is arrived at by subtracting the expenses from the revenue, keep to that, tell me why it is impossible for you or why your view is when, in fact the drilling of wells department and the absorption plant department, actually incurs some of those expenses, then why, as Mr. Morrison has done, should not those crude departments bear a portion of the expenses. There is nothing wrong, nothing illegal about it at all, it is just some accounting difficulty, you say?

A Well it is the reason which I have already given, it distorts the results from year to year.

Q It is the fact though, I do not know why the fact, why you should care about any distribution if the distribution actually arises out of what the fact is, why should that concern us. Well now, let us pass to the question of administration, I am equally bothered with knowing why the administration---

THE CHAIRMAN: Would you like a recess, Mr. Taylor?

WITNESS: Yes, I would, my Lord.

(A recess of five minutes was here taken).

Q MR. FRAWLEY: Mr. Taylor, you will understand of course, and I want to make myself quite clear, that I am not suggesting that the manner in which the books of the company have been kept to-date should have been kept in any different fashion for the purpose of allocating or failing to allocate the indirect expenses to the non-revenue producing department, you will understand that what I am suggesting to you is, that for the purposes of this Commission in endeavouring to arrive at the total cost, but only the total cost, to be put against the pipe-line division, that it would seem that there is some fault in any method, whomsoever's method it is and whatever you call it, which method fails to apportion to the other departments of the company their fair share of any expense which was in effect made, an expenditure actually incurred in these different departments, now that being the basis of my questioning of you, you understand that, that I am not concerned with the fashion in which the books were kept, now may I ask you whether or not you suggest there is anything wrong from the accounting standpoint when utility companies add to their capital expenditures a proportion of their administrative and indirect expenses which is, as an accountant would probably say, capitalizing those expenditures, is there anything wrong with that, you know that that is a common practice?

A I believe that that is a practice and in that connection I would like to read to you an extract from a publication I have here called "Twenty-five Years of Accounting Responsibility" by George Oliver May. I should explain that Mr. May is the chief of our firm in the United States, the Senior partner of our firm.

Q THE CHAIRMAN: I suppose you agree with the conclusion which is there stated?

A Yes, and I would like to read that, if I may.

Q All right?

A This is taken from evidence being given by Mr. May in the 1934, in the Western Power Corporation vs. the Commissioner of Internal Revenue, determination of fair value in June, 1930, of a block of 1,825,000 shares of Pacific Gas & Electric Company, being approximately 32% of the outstanding stock, and in the course of Mr. May's testimony he used these words:

"In the second place'

I have looked back over the record and I cannot see where Mr. May ever said "In the first place" but 'In the second place', he says:

'The Public Utility accounting calls for capitalizing large amounts of administrative expense which will be equally incurred, whether there are capital expenditures in progress or not; but the general rule in industrial accounting is to capitalize only such administrative expenses as would not have been incurred had the capital expenditure not been undertaken."

I take it from that that Mr. May is criticizing the practice of the utilities in capitalizing administrative expenses.

Q MR. FRAWLEY: He says it is only the common practice in industrial undertakings in the industrial businesses, to make any such allocation?

A He says industrial concerns but I think the same principles apply to this company.

Q That is, perhaps, where we may have to take some slight issue with you, you understand that there is in this Province a Statute which gives to the Board of Public Utility Commissioners the right to fix pipeline rates for pipeline companies or departments of companies operating pipelines?

A Yes.

Q That being so, I presume that for all practical purposes we have to regard this pipeline department as subject to the regulatory jurisdiction of the Public Utilities Board for rate-making purposes?

A Yes.

Q That makes it for all practical purposes an utility, does it not?

A Taking for granted your description of it, which I have no doubt is correct, I would say that that would be so.

Q Yes. Well, now, then, I just want to question you with regard to this minimum which you speak about, you said, as I understand, that there was in your view a minimum investment in boiler plants, in all these utilities and service units, is that so?

A I didn't say investment.

Q What was it, expense?

A Expense.

Q Well, now, the Royalite Oil Company, as we all know, is primarily in the business of producing crude oil for the Imperial Oil Company?

A That is, I would not say primarily, I think the pipeline operations of this company......

Q THE CHAIRMAN: Does not your own report say that?

A Primarily, yes, in the business of producing oil.

Q MR. FRAWLEY: Yes, that is right, that is what you say on page 1, the Royalite Oil Company is primarily a producing company. Of course, that is obviously so and nobody would take exception with that. This organization as an integrated company, whether they call their subsidiaries by separate names or not, they are in the business of producing under the name of the Royalite?

A Yes.

Q Manufacturing under the name of Imperial and marketing under the name of Imperial Oil Limited?

A But I do think that the pipeline operation has become more of a factor since there are a number of, a larger proportion of the other operators producing oil, all of which has to be handled by the pipeline.

Q The pipeline has become a very nice operation, it is true, but they are there primarily to transport their own oil or rather Imperial's oil, it is just a service?

A In the beginning that was so, but I think the proportions of other oils brought over the pipeline in the last two years, especially in the nine months ended September 30th, 1938, there was a very much relatively smaller proportion of Royalite oil to the total.

Q Well, we have, I think somebody gave us the percentage, Mr. McLeod or somebody, it was 70% Imperial, the B. A. had the balance, and a small proportion to the Lion Company?

A I do not think that is, my recollection is that there was a statement prepared showing the distribution of the pipeline......

Q Through-put?

A No, the pipeline adjustment account as it referred to

Royalite and my recollection is that the figures showed about 40% Royalite of the total in 1937 and about 22% in 1938. Now, I may have taken a wrong inference from that but that was the calculation which I made. I have the barrelage here and......

Q Oh, you mean, just a minute now, so that we will not be getting too far apart, you mean Royalite out of the Royalite wells?

A Yes.

Q Oh, yes, yes, but the oil in Turner Valley is bought, as we know, by these two companies in the main, the Imperial and the B. A.?

A Oh, yes.

Q I have a statement downstairs which I intend to file....

A I was talking of the relationship between Royalite's own oil and other oil.

Q Yes?

A From the point of view of the importance of the oil producing department versus the pipeline department, I thought that was a fact which, in my mind, worked into the situation.

Q I see what you mean, the Royalite Oil Company, without getting too far apart, the Royalite Oil Company produces a certain amount of oil under its own name, it buys a great deal more oil which it immediately sells to, instantaneously, perhaps, is the word, to the Imperial Oil Company?

A Yes.

Q And that oil is then transported through the pipeline?

A Yes, I was taking it from the operating point of view of production of oil by the Royalite against the pipeline operations by Royalite.

Q That is true Mr. Taylor.

A That is the comparison which I had in mind as putting in my mind the thought that, of the importance of the pipeline versus the producing.

Q Yes. Well now let us just distinguish that, I was drawing no distinction between the oil which the company produced out of Royalite Wells and the oil which it bought because the Imperial Oil Limited Refinery requirements exceed, both here and in Regina, exceed that what they themselves are producing, so they are buying considerable oil?

A Yes, they are buying oil but it does not come into their own production picture.

Q No, but it becomes their oil?

A That is the proposition.

Q That is the distinction you were drawing?

A Yes.

Q So we understand each other, so let me put it this way then, this company was originally then, whether, and you say in the main is still, but it was originally a crude producing department solely, that is true, that is right, it started out?

A Yes, that is how it started out.

Q At that time it had boiler plant expenses surely?

A It would have I imagine.

Q And it had electric plant expenses?

A Yes.

Q And it had engineering expenses?

A Yes.

Q Now how were they handled in those days, those expenses?

A There was no allocation to the pipeline for expenses.

Q No.

A There was not at this time, during all this trouble of trying

to arrive at, to set the cost of the pipeline department.

Q I know, but in those days there was allocated to the drilling of wells department, which may have been the only department, but there was allocated to that department all of the indirect expenses of the boiler plant and the electric light plant, and the engineering expenses and there was nothing awful about that from an accounting standpoint.

A I cannot see back in those days whether there was any other allocation made at all.

Q If there were not then, then they must have been capitalizing, to use your expression, they must have been adding to the expenditures incurred in the drilling of the wells, there was no other way?

A Well the wells were drilling.

Q Yes?

A Any operations, any production operations.

Q Any production operations?

A Yes, that would be so if there was any production.

Q That is true, then the thing you say they must not do now, because they have some other revenue producing department, was done without any great disturbance at all back in those days when presumably they only had a drilling wells department?

A Drilling wells and doing nothing else.

Q I do not want to pursue it any further, it seems to me there is nothing inherently wrong, Mr. Taylor, about putting against the drilling of wells department a portion of these indirect expenses, now I do not want to go over that forever and ever.

so mark [illegible], it [illegible] the right [illegible].

I know, but [illegible] college [illegible]

drilling [illegible], [illegible] have been [illegible]

department, [illegible] was [illegible] department [illegible]

the tuition [illegible]

electric light [illegible]

any questions [illegible] department.

[illegible] not [illegible]

[illegible] much [illegible]

[illegible] then [illegible] possibilities,

[illegible] examination, [illegible] to the

[illegible] of the college, there are

[illegible]

[illegible]

Yes?

any questions, [illegible]

[illegible]

Yes, [illegible] department.

[illegible] not go now,

[illegible] department,

was [illegible] those

[illegible] drilling walls [illegible]

[illegible]

[illegible]

[illegible], it seems [illegible]

[illegible] much [illegible]

[illegible]

[illegible] however

Q Now dealing with the question of administration and getting to the salaries of the Head Office people like Mr. John McLeod and Mr. T.E. Burns, using those just as typical?

A Yes.

Q Let me put it to you again, let us first find out what your system is. You say that no portion of Mr. McLeod's salary of Mr. T. Burns' salary should be, and you do not allocate, to the drilling of wells department or the building of Absorption Plants' department, for the reasons you have stated?

A That is correct. I should like to follow that up, Mr. Frawley, by giving you at this time the result of our distribution of the general and administrative expenses to the Pipe Line Department for the nine months ending September 1938, as shown on Exhibit C-8. I have just worked out the calculation, and the calculation is that 27% of the total of General and Administrative Expenses are charged against the Pipe Line Department, allocated on the basis used in our calculations and I consider that.........

Q Would you mind beginning again, we are not following you precisely. We perhaps did not hear what you said when you first started.

A We referred to Exhibit C-8.

Q Yes?

A We see there first a portion of the General and Administrative expense allocated to the Pipe Line Department of 13.5849% of $102,110.25.

Q Yes?

A Which gives a figure of $13,871.58.

Q Yes?

A Now there is a further allocation of General and Administrative Expenses comes through, a second allocation, which is the second figure inthe little lot of figures block d around in red?

Q Yes

A If we take the amount there of $47,953.53 and take say 29% of that - 28.8996 - then we find we get an amount almost equal to $13,871.58 which is charged above. So that this $13,871.58 is 13.58%. Therefore twice of that amount is about 27%. In my estimation that is a fair pro-ration to the Pipe Line Department for that type of expense. And that percentage emerges from the basis we have used in allocating general and administrative expense.

Q Why do you say it is fair?

A I consider it fair, having regard to the operations of the Company as a whole. I think the Pipe Line Department is at least a department which is about relative to say 25% of the total operations of the Company.

Q How about 1937, Mr. Taylor? Would you mind doing that and seeing how that works out?

A If you don't mind I won't work out all these decimal points.

Q Oh no?

A I make it roughly 25% of the total Just a minute. I must correct that. It is around 14%.

Q Yes, that is right?

A Yes.

Q So, Mr. Taylor, we have a situation then in 1938 of

27%, an allocation of 27% of the Administration Expenses to the Pipe Line Division, which is in your opinion fair, and in 1937 14% of the same expense is in your opinion fair? And so we go down the line. I do not know what the rest of them would show. I merely suggest to you that if 27% is fair, perhaps 14% is not and vice versa. Well now, Mr. Taylor....

THE CHAIRMAN: Perhaps you might wait for the witness' answer, what observation has he to make.

Q MR. FRAWLEY: Yes, quite?

A That is the way the calculation works out, and I would say that my first statement that 27% would not be out of line to the pipe line department stands. There may be an under-allocation in 1937.

Q That is what your system has done in any event, Your system has worked out that this allocation which is 27% in 1938 is 14% in 1937?

A That is correct.

Q And you say that, you just told me and you still say that 27% is fair? I put it to you, therefore, it is difficult to understand why the 14% is fair in 1937. Have you any comment to make on that, Mr. Taylor?

A No sir. That is how the calculation works out.

Q The calculation speaks for itself did you say?

A That is how the calculation works out.

Q That is how the calculation works out. Yes, I see. Well, that was the comment you made a moment ago and I take it you have no further comment to make. Mr. Taylor, will you come now to Exhibit "107" with me, which was a break-down of the $102,110.25?

J. W. Taylor

A Yes sir.

Q I see in that that $20,438.35 was spent in that year by the whole Royalite Company in administrative officers' salary?

A That is so, yes. That is what the statement shows.

Q Under the system which you have adopted, of allocating indirect costs, of which this is one, no portion of that $20,000.00 was allocated to the drilling of wells departme just to keep to that one?

A That is so.

Let me run down a few of them, and coming back perhaps and commenting on them. The next one that strikes my eye is that there was spent under the head Legal and Audit Fees $15,183.00?

A Yes sir, that is right.

Q And no portion of that was allocated to the drilling of wells department?

A That is so.

Q That is notwithstanding the fact that in the year 1938, for all you know, the Company may have had some very heavy litigation arising out of its well drilling operations, and paid and engaged a lot of Mr. Nolan's and his firm's time?

A That is so.

Q That does not matter to you?

A I did not inquire into the make-up of the legal fees.

Q It may be, and as far as you are concerned, keeping to the principle of your allocation, it may be that the whole of that $15,000.00 was paid to my friend's - not all of it because his firm does not do the auditing, your firm does that, - but suppose half of it went,

maybe we would find in breaking up that figure.....

THE CHAIRMAN: Surely more than half.

Q MR. FRAWLEY: Oh yes, that is not fair at all. But say my friend's firm took about $12,000.00 or $13,000.00 of that, and if we found in looking into it that my friend's firm spent the whole of that particular year in the drilling of wells department, and say the pipe line department went along, Mr. Coultis got along without the slightest legal assistance, that would not matter at all?

A I believe if there was such a situation, that that allocation might be made on the Company's books. I do not know as to that.

Q But I understood that you ignored the allocation on the Company's books, as I understood it?

A I could not say whether if there was an expense incurred, a legal expense, in connection with the drilling of wells, it might be - I cannot say but that might go directly to the wells drilling account. But I do not know as to that, or as to whether all the legal fees just sit and stay there in the Administrative Expenses.

Q That would be what you call capitalizing them would it not?

A Yes, it would be capitalized if it were charged direct.

Q Now I do not want to be at cross-purposes, because I do not want to be disagreeing with you as to what the fact is, but I rather figured from looking at Sheet that that amount, that these legal fees were part of the administration expenses and no portion was allocated to the drilling of wells department. That is what it means

[illegible]

on the surface?

A Yes, that is what it means on the surface.

Q There is no point in me pursuing this line of cross-examination with you, if that is not the factl

THE CHAIRMAN: Whatever the books may disclose, working on the basis on which this witness did, he did not take them into account as being properly charged against drilling for example.

A No, that is right.

MR. NOLAN: Or any of them,

MR. FRAWLEY: But just dealing with this one at the moment.

MR. NOLAN: Deal with another one for a change would you please?

MR. COMMISSIONER LIPSETT: I thought he dealt with it because he considered good value was given.

MR.NOLAN: If the rate of return was adequate.

A Would that both refer to the legal fees and the audit fees?

MR. FRAWLEY: Yes, both.

Q I venture to say the auditors did not overlook the drilling of wells department in their work, you hope they would not?

A No, they would look at that.

Q But whether they looked at it or not the drilling of wells department certainly bore no portion of the audit whatever is in this $15,000.00 for auditors' fees?

A That is correct on our basis of allocation.

Q And on the basis that has been submitted, because this figure is naturally of importance, because we find it

in your Exhibit "100". Well, that is what you say Mr. Taylor, is notwithstanding that the fact may be, and the fact is you say, that your auditors did audit the accounts and looked through the accounts of the drilling of wells department and the fact that Mr. Maw and Mr. Humphries may have spent a good many hours going into the drilling of wells department account, still because of your peculiar accounting system presented to this Commisson, no portion of that expense, the actual hours spent and the hours paid for, is charged to the drilling of wells department, and therefore, that much much more is charged to my pipe line department.

THE CHAIRMAN: He does not concede it to be peculiar.

MR. FRAWLEY: No, it is only peculiar at the moment, to me, perhaps.

A I wish to say, Mr. Frawley, I remember when it came to billing the Royalite job there had been a great deal of work carried out on capital expenditures and we were not able to collect for it because the fee went up so much that they did not - we were not reimbursed for that. So we can take it that that feature, the time that we had spent on the drilling of wells, we did not collect for it. Out fee would have been that much larger. So we did not collect the full fee for all the work that was done in connection with the capital items during that year, because the increase was so much that we could not collect. So that that means that there is nothing in there for the capital expenditure work we did.

Q That might mean a lot of things. You mean to say your Company rendered an account to the Royalite Company for work done in auditing or supervising the accounts in the well drilling department and they refused to pay you for that?

A I know the account went through my office in Toronto, and it showed such an increase over the year before that we had to cut down on it.

Q That may be something else altogether.

A I am just giving you that little sidelight on the thing?

Q Oh sure. The bill may have been too much and they cut you down, but that has nothing to do with this allocation being right or wrong?

A Oh no, I did not intend it to be fitted into the picture.

Q There is one more item I can take either now or in the morning, the Workmen's Compensation Board assessment. I suppose there are some men covered by the Workmen's Compensation Board $3200.00, I bet, well I should not say I bet - but I assume Mr. Taylor, that there are some drillers in there?

A Yes.

Q But the pipe line people are paying for it under your system?

A Not for all of it.

Q No, the pipe line, not for all of it. But all of these unfortunate revenue producing departments of this Company are paying for the drillers' assessments. I mean that is frankly what it is?

A All the operating departments are paying for it under our allocation.

Q And the drilling of wells department where the men work and are exposed to injury and, therefore, that is why the assessment was made, they are not paying for it under this allocation?

A There is no allocation under this to drilling of wells.

(At this stage the Hearing was adjourned until 10.30 A.M. 26th January, 1939.)

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